New avenues in Business Cycle Research

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These lectures will begin by a brief review and a critical assessment of the dominant theories of business cycles. We will then discuss the challenges and desirability of building a macroeconomic model where demand forces drive fluctuations without relying on sticky prices. We will present and explore the idea that news, sentiment and uncertainty may be key drivers of business cycles. We will also discuss a set of empirical observations that have motivated this alternative line of inquiry. In the process, we will discuss the merits and pitfalls of using VAR evidence for motivating business cycle research. As an organizing framework, we will show how the notion of strategic complementarities can be used for understanding business cycle fluctuations. The course will introduce the student to notions of limit cycles, sunspots and deficient demand in stochastic general equilibrium settings. The course will also discuss the different policy implications of these alternative views regarding business cycles

The first section of the course will build on

Beaudry and Portier, ''News Driven Business Cycles: Insights and Challenges'', Journal of Economic Literature, 2014.

Students wanting to prepare for the course are encouraged to read parts of the above article.

<u>Backgroud readings:</u>

The course will assume that the student is familiar with the basic Real Business Cycle Model and the New Keynesien model as presented in many textbook. The following are examples of background reading associated with these two models

Christiano, L., M. Eichenbaum and C. Evans, "Nomimal Rigidities and the Dynamic Effects of Monetary Shocks", Journal of Political Economy, 2005, 113(1), 1-45.

Smets, F and R. Wouters, 2007, Shocks and Frictions in US Business Cycles: A Bayesien DSGE approach. American Economic Review, 97, 586-606.

R. King and S. Rebello (1999). Resuscitating Real Business Cycles, In Taylor, Woodford, Handbook of Macroeconomics, 927-1007

Gali, J. And M. Gertler (2008) Macroeconomic Modeling for Policy Evaluation, Journal of Economic Perspectives, vol 21, 25-45

Walsh, C. Monetary Theory and Policy, MIT Press 2003, section 5.3.

Plan of Couse

1) The consensus business cycle models and their critics

2) Exploring the idea of demand driven business cycle without depending on sticky prices

2.1) A basic model of news driven business cycles

2.2) Introduction to Vars and application to the identification of news shocks.

2.3) Challenges of building equilibrium models driven by demand.

- Illustrating non-inflationary demand driven business cycles, and discussing the role of time varying gains from trade

3) Moving away from the Walrasian Framework

3.1) Introducing strategic complements and their role in understanding business cycle fluctuations

- Begin with static framework and then incorporate it into dynamic setting.
- Introducing ideas of limit cycles, sunspots and hysteresis

3.2) Modelling deficient demand and exploring the implications

- Application: the Hayek-Keynes controversy

4) Discussion of avenues for future research

For each section of the course, presentation slides will be made available.

Some Complementary readings

1. News and other demand driven business cycles

Angeletos and La'O "Noisy Business Cycles" NBER Macroeconomic Annual 2009.

Angeletos and La'O" Sentiment" Econometrica 2013.

Beaudry and Portier, ''News Driven Business Cycles: Insights and Challenges'', Journal of Economic Literature, 2014.

Beaudry and Portier (2007), ``When can Changes in Expectations Cause Business Cycle Fluctuations'', Journal of Economic Theory.

Pigou, A. Industrial Fluctuations, London: MacMillan 1927.

Beaudry and Portier (2004), ``Exploring Pigou's Theory of Cycles'', Journal of Monetary Economics.

Bloom, N., The Impact of Uncertainty Shocks. Econometrica, 2009.

Lorenzoni, G. (2008). A Theory of Demand Shocks. American Economic Review, 2009.

2. Vars and identification of meaningful patterns

Beaudry and Portier (2006), `` News, Stock Prices and Economic Fluctuations'', American Economic Review, 1293-1307.

Beaudry,P. and B. Lucke, Letting Different Views of Business Cycles Compete, NBER Macro Annual 2009.

Blanchard, O. And D. Quah, The Dynamic Effects of Aggregate Demand and Supply Disturbances, American Economic Review, 79, 1989, 655-73

Chari, VV, P. Kehoe and H. McGratton, Are Structural VARS with Long Run Restrictions Useful in Developing Business Cycle Theory, Journal of Monetary Economics 55, 1337-1352, 2008..

Fernandez-Villaverde, J., J. Rubio-Ramirez, and T. Sargent, A, B, C's (AND D)'s For Understanding VARs, AER, 97:1021-1026..

Cochrane, J. (1994), Shocks, Carnegie-Rochester Conference Series on Public Policy. 295-364, 1994.

Gali, J. (1999) Technology, Employment and Business Cycle: Do Technology Shocks Explain Aggregate Fluctuations? American Economic Review 89, 249-71

Fisher, J. (2006), The Dynamic Effects of Neutral and Investment Specific Technology Specific Shocks, Journal of Political Economy 114, 413-451.

3. Exploring models of news driven business cycles

Beaudry and Portier "Non-Inflationary Demand Driven Buisness Cycles" NBER macroeconomic annual, 2013.

Jaimovich, N. And S. Rebello, Can News about the future Drive Business Cycles? American Economic Review, 2009.

Christiano, L, R. Motto and M. Rostagno, (2007), Monetary Policy and the Stock Market Boom-Bust Cycle.

Schmitt-Grohe, S. And M. Uribe (2012), Whats News in Business Cycle?, Econometrica.

DenHaan and G. Kattenbrunner (2009). Anticipated Growth and Business Cycles in Matching Models, Journal of Monetary Economics.

4. Departing from Walrasian models and understanding deficient demand

Cooper, R and A. John " Coordinating Coordination Failures in Keynesien Models" Quarterly Journal of Economics, 1988.

Farmer, R. The Macroeconomic of Self-Fulfilling Prophescies. MIT Press 1998.

Beaudry, Galizia and Portier "Reconciling Hayek and Keynes view of Business Cycles" NBER working paper 2014.

Beaudry, Galizia and Portier "Reviving the limit Cycle view of Macroeconomic Fluctuations" NBER working paper 2015

Beaudry, Galizia and Portier ''Is the macroeconomy locally stable, and should we care?'' Forthcoming at the 2016 NBER Macroeconomic Annual.