Macroeconomic Theory II.  
14.452, Spring 2003

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This is the second course in the four-quarter graduate sequence in macroeconomics. Its purpose is to introduce the basic models macroeconomists use to study fluctuations.

My email is blanchar@mit.edu. The TA for the course is Ruben Segula-Cayuela (rubens@mit.edu). The course is part of the OCW MIT project and the web page can be accessed from http://web.mit.edu/course/14/14.452/www/
Lecture notes for 2002 are posted there. Lecture notes for 2003 will replace them as the course progresses. (The structure of the course is roughly the same as last year).

It is essential that you be familiar with macroeconomics at the intermediate undergraduate level. If you have not done so yet, read an intermediate macro text (Take this recommendation seriously. If you are not familiar with macroeconomics, the risk is high that you will perceive the course as a series of methods and models, not as an attempt to understand fluctuations). Some texts are at a slightly higher level than others. Let me mention two:

Abel, A. and B. Bernanke, Macroeconomics, Addison-Wesley, 2002

Blanchard, O. , Macroeconomics, Prentice Hall, 2003

There are no textbooks for the course. However, I shall use material from:

Blanchard, O. and S. Fischer, Lectures on Macroeconomics, MIT Press 1989. (BF in what follows) [covers most bases, but is aging]

Ljungqvist, L. and T. Sargent, Recursive Macroeconomic Theory, MIT Press 2000 [focuses more on techniques]

Woodford, M. Interest and Prices, mimeo Princeton, 2002. [focuses more on nominal rigidities, and the role of monetary policy]. Available at http://www.princeton.edu/~woodford/

Macroeconomics is a rapidly changing field. To get a sense of the geography, you might find it useful to read two recent surveys:


The course is organized around nine topics/sections. For each topic, I have included basic readings, as well as a few papers showing further applications or extensions. A star denotes required reading.

1. Fluctuations. Facts.


Co-movements of GDP components. Correlations between real wages, interest rates, and output. The correlations of output and money.

Cycles, slumps, and depressions. Non linearities?

* BF, Chapter 1
2. The basic model. The consumption/saving choice.

Setting up the optimization problem. Intertemporal choice, shocks, uncertainty. The first order conditions.

Solving the model. Numerically. Value functions. Log linearization. Special cases and other short cuts.

Equivalence between centralized and decentralized economies. The consumption problem in the decentralized economy.

* BF, Chapter 2 and Section 6-2.

OR, Chapters 1 and 2

* LS, Chapters 2 and 3

* Campbell J., Inspecting the Mechanism: An Analytical Approach to the Stochastic Growth Model, JME, 33, June 1994, 463-506
3. Allowing for a labor/leisure choice. (the RBC model)


* BF, Chapter 7


Basu, S. and Fernald, J., “Why is Productivity Procyclical? Why Do We Care?,” NBER W7940, October 2000


4. Allowing for non trivial investment decisions.

Costs of adjustment for investment. Investment, consumption, and interest rates in the decentralized economy. The role of the term structure of interest rates. The stock market and investment. The effects of shocks on output, investment, the stock market, and the term structure.

The open economy version. Shocks, investment, saving, and movements in the current account.

Asset price bubbles, investment, and fluctuations
5. Allowing for two goods.


The consumer problem with two goods. Intratemporal and intertemporal first order conditions.

Closing the model if tradables/non tradables. The Balassa-Samuelson effect. The transfer problem. Effects of technological shocks on relative prices, and on the current account.

OR, Chapter 4


6. **Introducing money.**


* BF, Sections 4.3 to 4.7; and Section 10.2

Woodford, M. Chapter 2-1, "Price Level Determination Under Interest Rate Rules"


7. **Introducing price setting.**


* BF, Sections 8-1, 11-4

* Woodford, M., Chapter 3-1 ("Optimizing Models with Nominal Rigidities. A Basic Sticky-Price Model")


8. **Current and Past Workhorses**

* BF, Chapter 8-2, 8-3

* Woodford, M., Chapter 3-2 ("Optimizing Models with Nominal Rigidities. Inflation Dynamics with Staggered Price Setting.)


9. Applications to fiscal and monetary policy.


Woodford, M., Chapter 4-1, 4-2 ("A Neo-Wicksellian Framework for the Analysis of Monetary policy")


Krugman, P. “It is Baaack: Japan's Slump and the Return of the Liquidity Trap,” BPEA, 1998-2, 137-201

Shirakawa, M. `Monetary Policy Under the Zero Interest Rate Constraint and Balance Sheet Adjustment", International Finance, 4:3, 2001, 463-489
