

Core Macroeconomics

Hillary Term 2008

Week 2: Business Cycles

Reading

In this topic, we continue thinking about fluctuations. After the rational expectations revolution, macroeconomic thought has developed two main research agendas. The first, real business cycle theory, uses rational expectations models to explain why serially-correlated shocks to the supply-side of the economy can generate business cycles. The second, new Keynesian macroeconomics, uses models with nominal rigidities to explain why business cycles can occur even in the presence of rational agents. For RBC models, first, you should read Mankiw (2005)** chapter 19 which provides a very clear non-technical introduction, and then Romer (1996)**. Carlin & Soskice (2006) pp. 55-58 and section 2 of Chapter 15 also provide some insight into RBC models. Additional references for understanding RBC models can be found in Mullineux & Dickinson (1992), Plosser (1989) and Stadler (1994). You may also wish to look at the articles in the *Oxford Review of Economic Policy* issue of Autumn 1997: Cooley (1997), Millard, Scott & Sensier (1997) and Muellbauer (1997). A U.K. perspective on RBC can be found in Holland & Scott (1998).

A good introduction to New-Keynesian models is provided by the introduction to the Mankiw & Romer (1991) book, which also contains reprints of important papers by Mankiw (1985), Fischer (1977), Yellen (1984) and Blanchard & Summers (1987). Mankiw (1989) provides a bridge between the two theories. Essays written on business cycles must be able to discuss these two main theories and adjudicate between them.

Take notes on:

1. Staggered wage contracts and menu costs
2. Coordination Failures
3. Sources of Real Shocks
4. Propagation Mechanisms
5. Empirical Validity of RBC Models
6. U.S. and U.K. Productivity and Consumption Growth in the 1990s

Class Assignment

Prepare a short presentation and detailed notes on your assigned topic (see syllabus for schedule) and be prepared to give a presentation in class. Also remember to bring copies for your cohort.

References

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- Holland, A. & Scott, A. (1998), 'The determinants of uk business cycles', *The Economic Journal* **108**(449), 1067–92.
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- Millard, S., Scott, A. & Sensier, M. (1997), 'The labour market over the business cycle: can theory fit the facts?', *Oxf Rev Econ Policy* **13**(3), 70–92.

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