Core Macroeconomics

Hillary Term 2008

Week 1: Economic Fluctuations and Nominal Inertia

Reading

This topic is designed to provide an outline of the sources of economic fluctuations due to nominal inertia – that is, how prices which are not fully flexible, also known as "sticky" – can distort economic decisions, and in turn lead to economic fluctuations. You should begin by reading Carlin & Soskice (2006)** chapters 1-3. The main topic of this tutorial is to review the New Classical Model of Lucas and Friedman's Adaptive Expectations model and to understand how imperfect competition can lead to economic fluctuations. In Carlin & Soskice (2006) pay close attention to figure 2.14 and the summary questions at the end of chapter 2, as well as the discussion of the Phillips curve in chapter 3. Next read parts A and B of chapter 6 of Romer (2006). Also read Ball, Mankiw & Romer (1988) as well as the introduction by Mankiw & Romer (1991). Further reading on the microeconomic foundations of New Keynesian economics can be found in chapter 15 of Carlin & Soskice (2006).

Essay

A: "Abandoning the assumptions of perfect competition is essential if aggregate demand is to influence output"

B: "New Keynesian Models provide a better account of the output-inflation tradeoff than the Lucas Model"

References

Ball, L., Mankiw, N. G. & Romer, D. (1988), 'The New Keynesian Economics and the Output-Inflation Trade-off', *Brookings Papers on Economic Activity* **1988**(1), 1–82.

Carlin, W. & Soskice, D. (2006), *Macroeconomics: Imperfections, Institutions and Policies*, Oxford University Press.

Mankiw, N. G. & Romer, D. (1991), Introduction, *in* N. Gregory & D. Romer, eds, 'New Keynesian economics', MIT Press, Cambridge, Mass ; London.

Romer, D. (2006), *Advanced Macroeconomics*, 3 edn, McGraw-Hill Higher Education.