

## Subjects for presentations

Bengt Assarsson Spring 2010

1) *Difference between IS/LM/AD and 3-equations model*, (**Carlin and Soskice 2005**), (Blanchard 2003) or any other similar textbook, (Romer 2000)

2A) *Are prices sticky? How sticky?*, (Alvarez 2006), (**Apel, Friberg et al. 2005**), (Bils and Klenow 2004)

2B) *Are prices sticky? How sticky?*, (Alvarez 2006), (Apel, Friberg et al. 2005), (**Bils and Klenow 2004**)

3A) *Inflation and market structure. Does monopolistic competition explain that monetary policy has real effects?*, (Dixon and Rankin 1994), (**Blanchard and Kiyotaki 1987**), (Jonsson 2007)

3B) *Does increased competition lower inflation?*, (Dixon and Rankin 1994), (Blanchard and Kiyotaki 1987), (**Jonsson 2007**)

4A) *Measurement problems in the New Keynesian Phillips Curve*, (Basistha and Nelson 2007), (Neiss and Nelson 2005), (**Gali and Gertler 1999**)

4B) *Is expectations of inflation forward or backward looking?*, (**Gali and Gertler 1999**)

5A) *What inflation measure should a central bank target?*, (**Mankiw and Reis 2003**), (Wynne 1999)

5B) *Should the central bank target wage inflation?*, (Mankiw and Reis 2003), (Wynne 1999), (**Erceg, Henderson et al. 2000; Gali 2008**)

6A) *Merits of microfoundations for macroeconomics*, (**Chari and Kehoe 2006**), (Kirman 1992), (Solow 2008)

6B) *What is the problem with representative agents?*, (Chari and Kehoe 2006), (**Kirman 1992**), (Solow 2008)

7A) *The tradeoff between inflation and real targets in monetary policy*, (Palmqvist 2007), (**Clarida, Gali et al. 1999**),

7B) *Is flexible inflation targeting a good idea?*, (**Palmqvist 2007**), (Clarida, Gali et al. 1999),

Papers marked in **boldface** are the main paper to be presented. The other papers may support or contradict the paper to be presented and might be useful for both the presenters and the discussants. Take advice from the teacher about how to write the presentation, which should be 2-3 pages long.

## References

Alvarez, L. J. (2006). "Sticky Prices in the Euro Area: A Summary of New Micro-evidence." Journal of the European Economic Association 4(2-3): 575-584.

This paper summarises the vast evidence on micro price-setting recently obtained for euro area countries. We consider studies with micro data on consumer and producer prices, as well as survey information. The main findings are: (1) prices in the euro area are sticky and stickier than in the US; (2) downward price rigidity is only slightly more marked than upward price rigidity; (3) heterogeneity and asymmetries are observed in price-setting; and (4) the relevance of theories that explain price stickiness, such as implicit or explicit contracts, marginal costs, and coordination failure, is confirmed, whereas menu costs, pricing thresholds, and costly information explanations are judged much less relevant by firms.

Apel, M., R. Friberg, et al. (2005). "Microfoundations of Macroeconomic Price Adjustment: Survey Evidence from Swedish Firms." Journal of Money, Credit, and Banking 37(2): 313-338.

This paper presents the results of a survey on price-setting behavior conducted on a large random sample of Swedish firms. The median firm adjusts the price once a year. State- and time-dependent price setting are about equally important. The four highest-ranked explanations for price rigidity in this study (implicit contracts, sluggish costs, explicit contracts, and the kinked demand curve) have close correspondents among the top five places in two similar large-scale surveys carried out in the UK and the U.S. The results point to the importance of the long-term relations with customers for the rigidity of prices (the estimated share of sales that go to regular customers is more than 80%).

Basistha, A. and C. R. Nelson (2007). "New Measures of the Output Gap Based on the Forward-Looking New Keynesian Phillips Curve." Journal of Monetary Economics 54(2): 498-511.

Forward-looking versions of the New Keynesian Phillips curve imply that the output gap, the deviation of the actual output from its natural level due to nominal rigidities, drives the dynamics of inflation relative to expected inflation. We exploit this to set up a bivariate unobserved component model for extracting new estimates of the output gap in the US. The gap estimates are large and persistent even after allowing for correlated trend and cycle shock. We then augment our model to use the information in the unemployment rate. The estimates confirm the presence of a large and persistent cyclical component.

Bils, M. and P. J. Klenow (2004). "Some Evidence on the Importance of Sticky Prices." Journal of Political Economy 112(5): 947-985.

We examine the frequency of price changes for 350 categories of goods and services covering about 70 percent of consumer spending, on the basis of unpublished data from the Bureau of Labor Statistics for 1995-97. In comparison with previous studies, we find much more frequent price changes, with half of prices lasting less than 4.3 months. Even excluding temporary price cuts (sales), we find that half of prices last 5.5 months or less. We also find that the frequency of price changes differs dramatically across goods. Compared to the predictions of popular sticky-price models, actual inflation rates are far more volatile and transient for sticky-price goods.

Blanchard, O. (2003). Macroeconomics, Prentice Hall.

Blanchard, O. J. and N. Kiyotaki (1987). "Monopolistic Competition and the Effects of Aggregate Demand." American Economic Review 77(4): 647-666.

How important is monopolistic competition to an understanding of the effects of aggregate demand on output? The authors ask this question at three levels. Can monopolistic competition, by itself, explain why aggregate demand affects output? Can it, together with other imperfections, generate effects of aggregate demand in a way that perfect competition cannot? If so, can it give an accurate account of the response of the economy to aggregate demand movements? The answers are no, yes, and yes.

**Carlin, W. and D. Soskice (2005). "The 3-Equation New Keynesian Model--A Graphical Exposition." B.E. Journals in Macroeconomics: Contributions to Macroeconomics 5(1): 1-36.**

**We develop a graphical 3-equation New Keynesian model for macroeconomic analysis to replace the traditional IS-LM-AS model. The new graphical IS-PC-MR model is a simple version of the one commonly used by central banks and captures the forward-looking thinking engaged in by the policy maker. Within a common framework, we compare our model to other monetary-rule based models that are used for teaching and policy analysis. We show that the differences among the models centre on whether the central bank optimizes and on the lag structure in the IS and Phillips curve equations. We highlight the analytical and pedagogical advantages of our preferred model. The model can be used to analyze the consequences of a wide range of macroeconomic shocks, to identify the structural determinants of the coefficients of a Taylor type interest rate rule, and to explain the origin and size of inflation bias.**

**Chari, V. V. and P. J. Kehoe (2006). "Modern Macroeconomics in Practice: How Theory Is Shaping Policy." Journal of Economic Perspectives 20(4): 3-3.**

**Over the last three decades, macroeconomic theory and the practice of macroeconomics by economists have changed significantly--for the better. Macroeconomics is now firmly grounded in the principles of economic theory. We focus on the role of economic theory in shaping policy. Over the last several decades, the United States and other countries have undertaken a variety of policy changes that are precisely what macroeconomic theory of the last 30 years suggests. The evidence that theoretical advances have had a significant effect on the practice of policy is often hard to see for policymakers and advisers involved in the hurly-burly of day-to-day policymaking, but easy to see if one steps back and takes a longer-term perspective. Examples of the effects of theory on the practice of policy include increased central bank independence; adoption of inflation targeting and other rules to guide monetary policy; increased reliance on consumption and labor taxes instead of capital income taxes; and increased awareness of the costs of policies that distort labor markets.**

**Clarida, R., J. Gali, et al. (1999). "The Science of Monetary Policy: A New Keynesian Perspective." Journal of Economic Literature 37(4): 1661-1707.**

The paper reviews the recent literature on monetary policy rules. We exposit the monetary policy design problem within a simple baseline theoretical framework. We then consider the implications of adding various real world complications. Among other things, we show that the optimal policy implicitly incorporates inflation targeting. We also characterize the gains from making a credible commitment to fight inflation. In contrast to conventional wisdom, we show that gains from commitment may emerge even if the central bank is not trying to inadvisedly push output above its natural level. We also consider the implications of frictions such as imperfect information.

Dixon, H. D. and N. Rankin (1994). "Imperfect Competition and Macroeconomics: A Survey." Oxford Economic Papers 46(2): 171-199.

This survey outlines the general lessons of recent literature on imperfectly competitive macroeconomics for the theory of monetary and fiscal policy. A general framework is presented which nests most of the existing literature. Although money is of itself neutral, the presence of menu costs, non-unit-elastic expectations, or sectoral nominal rigidities results in an output- and welfare-increasing role for monetary policy. Imperfect competition alone is enough for fiscal policy to affect output but, without monetary nonneutrality, the effect is as likely to be negative as positive. Nevertheless, fiscally induced output increases are likely to be welfare increasing, unlike in competitive economies.

Erceg, C. J., D. W. Henderson, et al. (2000). "Optimal Monetary Policy with Staggered Wage and Price Contracts." Journal of Monetary Economics 46(2): 281-313.

We formulate an optimizing-agent model in which both labor and product markets exhibit monopolistic competition and staggered nominal contracts. The unconditional expectation of average household utility can be expressed in terms of the unconditional variances of the output gap, price inflation, and wage inflation. Monetary policy cannot achieve the Pareto-optimal equilibrium that would occur under completely flexible wages and prices; that is, the model exhibits a tradeoff in stabilizing the output gap, price inflation, and wage inflation. We characterize the optimal policy rule for reasonable calibrations of the model. We also find that strict price inflation targeting generates relatively large welfare losses, whereas several other simple policy rules perform nearly as well as the optimal rule.

**Gali, J. (2008). Monetary Policy, Inflation, and the Business Cycle. Princeton, Princeton University Press.**

**Gali, J. and M. Gertler (1999). "Inflation Dynamics: A Structural Econometric Analysis." Journal of Monetary Economics 44(2): 195-222.**

**We develop and estimate a structural model of inflation that allows for a fraction of firms that use a backward-looking rule to set prices. The model nests the purely forward-looking New Keynesian Phillips curve as a particular case. We use measures of marginal cost as the relevant determinant of inflation, as the theory suggests, instead of an ad hoc output gap. Real marginal costs are a significant and quantitatively important determinant of inflation. Backward-looking price setting, while statistically significant, is not quantitatively important. Thus, we conclude that the New Keynesian Phillips curve provides a good first approximation to the dynamics of inflation.**

**Jonsson, M. (2007). "Increased competition and inflation." Sveriges Riksbank Economic Review(2): 41-60.**

**Kirman, A. P. (1992). "Whom or What Does the Representative Individual Represent?" Journal of Economic Perspectives 6(2): 117-136.**

**Mankiw, N. G. and R. Reis (2003). "What Measure of Inflation Should a Central Bank Target?" Journal of the European Economic Association 1(5): 1058-1086.**

**This paper assumes that a central bank commits itself to maintaining an inflation target and then asks what measure of the inflation rate the central bank should use if it wants to maximize economic stability. The paper first formalizes this problem and examines its microeconomic foundations. It then shows how the weight of a sector in the stability price index depends on the sector's characteristics, including size, cyclical sensitivity, sluggishness of price adjustment, and magnitude of sectoral shocks. When a numerical illustration of the problem is calibrated to U.S. data, one tentative conclusion is that a central bank that wants to achieve maximum stability of economic activity should use a price index that gives substantial weight to the level of nominal wages.**

Neiss, K. S. and E. Nelson (2005). "Inflation Dynamics, Marginal Cost, and the Output Gap: Evidence from Three Countries." Journal of Money, Credit, and Banking 37(6): 1019-1045.

Recent studies have argued that the New Keynesian Phillips curve (Calvo pricing model) is empirically valid, provided that real marginal cost rather than detrended output is used as the variable driving inflation. One interpretation of this result is that real marginal cost is not closely related to the output gap, and so models for monetary policy need to include labor-market rigidities. An alternative interpretation is that marginal cost and the output gap are closely related, but that the latter needs to be measured in a manner consistent with dynamic general equilibrium models. To date, there has been little econometric investigation of this alternative interpretation. This paper provides estimates of the New Keynesian Phillips curve for the U.S., the U.K., and Australia using theory-consistent estimates of the output gap. Using this theory to measure the output gap leads to a considerable improvement in the empirical performance of output-gap-based Phillips curves.

Palmqvist, S. (2007). "Flexible inflation targeting - how should central banks take the real economy into consideration?" Sveriges Riksbank Economic Review(2): 61-74.

Romer, D. (2000). "Keynesian Macroeconomics without the LM Curve." Journal of Economic Perspectives 14(2): 149-169.

Changes in both the macroeconomy and in macroeconomics suggest that the IS-LM-AS model is no longer the best baseline model of short-run fluctuations for teaching and policy analysis. This paper presents an alternative model that replaces the assumption that the central bank targets the money supply with an assumption that it follows a simple interest rate rule. The resulting model is simpler, more realistic, and more coherent than IS-LM-AS, not just in its treatment of monetary policy but in many other ways. The paper also discusses other alternatives to IS-LM-AS.

Solow, R. (2008). "Modern Macroeconomics in Practice: How Theory is Shaping Policy: Comments." Journal of Economic Perspectives 22(1): 243-246.

**Wynne, M. A. (1999). Core inflation: a review of some conceptual issues, Federal Reserve Bank of Dallas, Working Papers: 99-03.**

**This paper reviews various approaches to the measurement of core inflation that have been proposed in recent years. The objective is to determine whether the European Central Bank (ECB) should pay special attention to one or other of these measures in assessing inflation developments in the euro area. I put particular emphasis on the conceptual and practical problems that arise in the measurement of core inflation, and propose some criteria that could be used by the ECB to choose a core inflation measure.**