

Course Overview

Macroeconomics involves understanding, predicting and influencing the behavior of variables used to measure and characterize aggregate economic activity (e.g., output, inflation, unemployment, etc.).

Some important issues:

- Keys to enjoying high long-term economic growth.
- The appropriate role of government in influencing inflation, unemployment, etc.
- The impact of international trade on the macroeconomy.
- Macroeconomic implications of large government budget deficits.

We will address these and related issues using formal *economic models*.

Course Goal:

Become proficient in the use of Aggregate Supply / Aggregate Demand models of the macroeconomy, which include a set of economic variables to be explained (*endogenous variables*), a set of economic and policy variables to be taken as given (*exogenous variables*), and a set of equations which describe their behavior.

We will study one basic model: subtle variations of the behavioral equations included in the model can capture a wide array of assumptions regarding the economy, and can potentially generate sharply different predictions.

Note:

The goal of the course is *not* to provide *answers* to the key issues that arise in macroeconomics, but rather to equip you with a set of tools that you can use to provide and defend your own answers.

Requirements of the models:

- Employ realistic simplifying assumptions.
- Successfully explain observed patterns of economic behavior -- *stylized facts*.
- Consistently generate accurate forecasts of future economic activity.
- Generate reliable policy recommendations.

Overview of the AS/AD Model

Aggregate Demand:

All P, Y combinations such that Aggregate Expenditures ($C+I+G+NX$) equal output.

The AD model is decomposed into two sectors: the goods and monetary sectors.

Goods Sector (**IS model**): all r, Y combinations such that $AE = Y$

Monetary Sector (**LM model**): all r, Y combinations such that money supply = money demand.

Combining the IS and LM models, holding the aggregate price level (P) fixed, yields the AD model.

Aggregate Supply:

All P, Y combinations firms are willing and able to produce in pursuit of profit-maximization objectives.

Three scenarios:

Short Run: the aggregate level of technological advancement, the aggregate capital stock, and input costs (e.g., wages) are fixed.

Long Run: variable input costs, with fixed levels of technological advancement and the aggregate capital stock.

Very Long Run (Economic Growth): Variable capital stock and technological progress.

Diagram of the AS/AD Model

