

Advanced Macroeconomics I

Lecture 1 (1)

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- What is Macroeconomics?

It is the study of aggregate production, consumption, investment and prices in large economic systems comprised of many participants (whom we will call agents)

- Why study Macroeconomics?

The questions are too big and too important to ignore

- Why are some countries so rich while other countries so poor?

Per capita GDP:

Rank	Country	US\$
1	Luxembourg	104,390
2	Norway	84,543
4	Switzerland	67,074
9	United States	47,132
95	China, People's Republic of	4,283
181	Congo, Democratic Republic of the	188
182	Burundi	177

data: International Monetary Fund (2010)

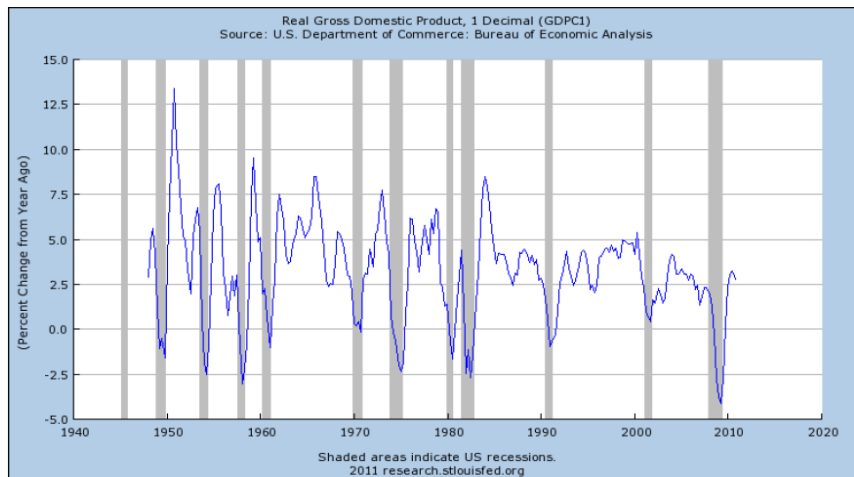
- Why do some economies grow at 2% per year, while other grow at 9% per year?

Rank	Country	Growth rate 2009	average growth rate 2000-2009
5	China	9.1	9.8
11	Congo	7.5	4.6
109	Norway	-1.4	1.9
132	United States	-2.6	1.8

2009 List by the International Monetary Fund

Questions continued

- Why do recessions (or short-term reductions in output) occur in countries that exhibit persistent growth?



- What causes financial crises? What is the relationship between financial crises and economic downturns?
 - Understanding causalities is a pre-condition for good policymaking, since bubbles and crises will occur again if the sources are not addressed directly
 - south-east Asia in 1997, Russia in 1998, Brazil in 1999, the dot.coms in 2000
 - A real economy downturn — must associated with a financial crisis
 - A financial crisis — may or may not associated with a real economy downturn

- What is the cause and influence of moderate and high inflation?
 - Moderate inflation may encourage investment and growth, reduce unemployment
 - High inflation may discourage the holding of money, encourage excessive consumption, redistribute wealth between debtor and lender
- What is the cause of unemployment?
 - Why firms do not lower the wage to get full employment?

- Tools:
 - Fiscal policy
 - Monetary policy
- Goal of policies
 - Growth
 - Stabilization
 - Inflation
 - Unemployment

- 1 Write down a model
- 2 Solve the model for a refutable hypothesis
- 3 Take the model to data
- 4 If the model is consistent with the data, accept the hypothesis and keep the model. If not, reject the hypothesis and discard the model

Purpose of writing a model

- Theory as data reduction
A good theory compresses data with minimal loss of information
- Understand the mechanism of the economy
- Policy experiment

- Provide methodological tools for advanced research in macroeconomics
 - The emphasis is on theory, although data guides the theoretical explorations
 - We build entirely on models with microfoundations
 - models where behavior is derived from basic assumptions on consumers' preferences, production technologies, information, and so on.
 - Behavior is always assumed to be rational:
 - all actors in the economic models are assumed to maximize their objectives