

Economics 505: Macroeconomic Theory II

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Office hours: Mondays, 10:00 – 11:15 am or by appointment

Prerequisite: Economics 504, Macroeconomic Theory I, or equivalent.

Objectives and Learning Outcomes: This course is the second part of a two-semester sequence in macroeconomics. The sequence aims to introduce students to a broad range of issues at the Ph.D. level and to develop useful analytical tools for doing research in macroeconomics. This course will build on the dynamic models used in Economics 504 and will introduce frictions that allow us to study topics related to monetary policy, labor markets, unemployment, financial intermediation and financial crises.

Class meetings: Monday and Thursday, 11:30 - 12:50, Murray Hall 208

Attendance: Students are expected to attend all class meetings and to actively participate in discussions by asking and answering questions. If you will miss more than one class because of illness or a family emergency, please contact me as soon as possible.

Recitation Sections: There will be recitation sections devoted to solving problems or reviewing complementary material on Tuesdays, 11:30 - 12:50, in Murray Hall 115. These sections will not meet every week; meeting dates will be announced in advance.

Grading: Course grades will be based on the following:

Problem sets	10%	
Exam 1	40%	March 2 (Thursday)
Exam 2	50%	May 1 (Monday)

Students are allowed (and encouraged) to discuss and collaborate with each other on problem sets. The course material is difficult and you can learn a lot from each other by working together. Each student must submit an individual solution for grading, however.

Exams will be closed book: no use of notes or communication among students is permitted.

Academic Integrity: Students must follow the Rutgers Academic Integrity Policy, which is available at <http://academicintegrity.rutgers.edu/academic-integrity-policy/>. All academic integrity violations will be referred to the proper authorities and may have significant consequences.

Course Materials: We will draw material from many different sources, some of which are listed in the course outline below. Some useful reference books are:

- 1) Lars Ljungqvist and Thomas J. Sargent, *Recursive Macroeconomic Theory*, Third Edition, MIT Press, 2012.
- 2) Christopher A. Pissarides, *Equilibrium Unemployment Theory*, 2nd ed., MIT Press, 2000.
- 3) Steve Williamson, *Notes on Macroeconomic Theory*, 2006.
- 4) Franklin Allen and Douglas Gale, *Understanding Financial Crises*, Oxford University Press, 2007.

Course outline: The outline below provides a tentative list of the topics we will cover along with selected readings for each topic. This list may be revised over the course of the semester.

Part I: Markets with Search and Matching Frictions

- a) Introduction to job search (one-sided search)

Ljungqvist & Sargent, Chapter 6

Kehoe, Timothy J. (2011) “[Notes on McCall’s model of job search.](#)”

Williamson, Section 7.1

McCall, John J. (1970) “[Economics of information and job search,](#)” *Quarterly Journal of Economics* 84:113-126.

- b) Search and matching in the labor market (two-sided search)

Pissarides, Chapters 1 – 3

Williamson, Section 7.1

- c) Search, production and exchange

Diamond, Peter A. (1982) “[Aggregate demand management in search equilibrium.](#)” *Journal of Political Economy* 90:881–894.

- d) Search and monetary exchange

Williamson, Chapter 9

Ljungqvist & Sargent, Chapter 28

Additional readings:

Nobel Prize Committee (2010) “[Markets with Search Frictions.](#)”

Rogerson, Richard, Robert Shimer, and Randall Wright (2005) “[Search-Theoretic Models of the Labor Market: A Survey,](#)” *Journal of Economic Literature* 43: 959-988.

Rogerson, Richard and Robert Shimer (2011) “[Search in Macroeconomic Models of the Labor Market,](#)” *Handbook of Labor Economics* 4(A): 619-700.

Part II: Financial intermediation and financial crises

Introductory readings:

Allen & Gale, Chapters 1 and 2

Bernake, Ben (2012) “[Some Reflections on the Crisis and the Policy Response.](#)”

Brunnermeier, Markus (2009) “[Deciphering the liquidity and credit crunch 2007-8](#)”,
Journal of Economic Perspectives 23:77-100.

a) Demand deposits and bank runs

Allen & Gale, Chapters 3 and 5

Diamond, Douglas W. and Phillip H. Dybvig (1983) “[Bank runs, deposit insurance, and liquidity](#),” *Journal of Political Economy* 91: 401-419.

b) Contagion: Why crises spread

Allen & Gale, Chapter 10

Allen, Franklin and Douglas Gale (2000) “[Financial contagion](#),” *Journal of Political Economy* 108: 1-33.

c) Policy responses to financial fragility

Wallace, Neil (1996) “[Narrow banking meets the Diamond-Dybvig model](#),” Federal Reserve Bank of Minneapolis *Quarterly Review* 20 (Winter): 3-13.

Ennis, Huberto M. and Todd Keister (2009) “[Bank Runs and Institutions: The Perils of Intervention](#),” *American Economic Review* 99:1588-1607.

Part III: Overlapping generations

a) Pure exchange models: efficiency, dynamics, and money

Ljungqvist & Sargent, Chapter 9

Williamson, Chapter 10

Samuelson, Paul A. (1958) “[An exact consumption loan model of interest with or without the social contrivance of money](#),” *Journal of Political Economy*, 66: 467-482.

Shell, Karl (1971) “[Notes on the Economics of Infinity](#),” *Journal of Political Economy*, 79: 1002-1011.

b) Capital accumulation, money and banking in overlapping generations

Williamson Chapter 2

Diamond, Peter A. (1965). “[National debt in a neoclassical growth model](#),” *American Economic Review* 55: 1126-1150.

Bencivenga, Valerie and Bruce Smith (1991) “[Financial Intermediation and Endogenous Growth](#),” *Review of Economic Studies* 58, 195-209.