

# EE312: Macroeconomics Theory:

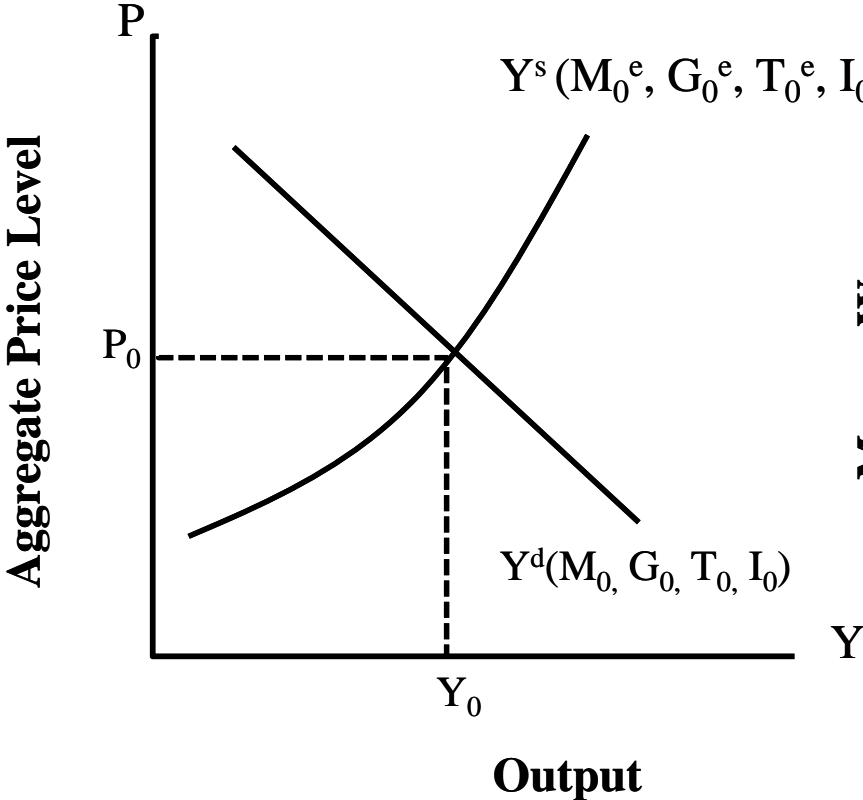
New Classical Economics

Real Business Cycles

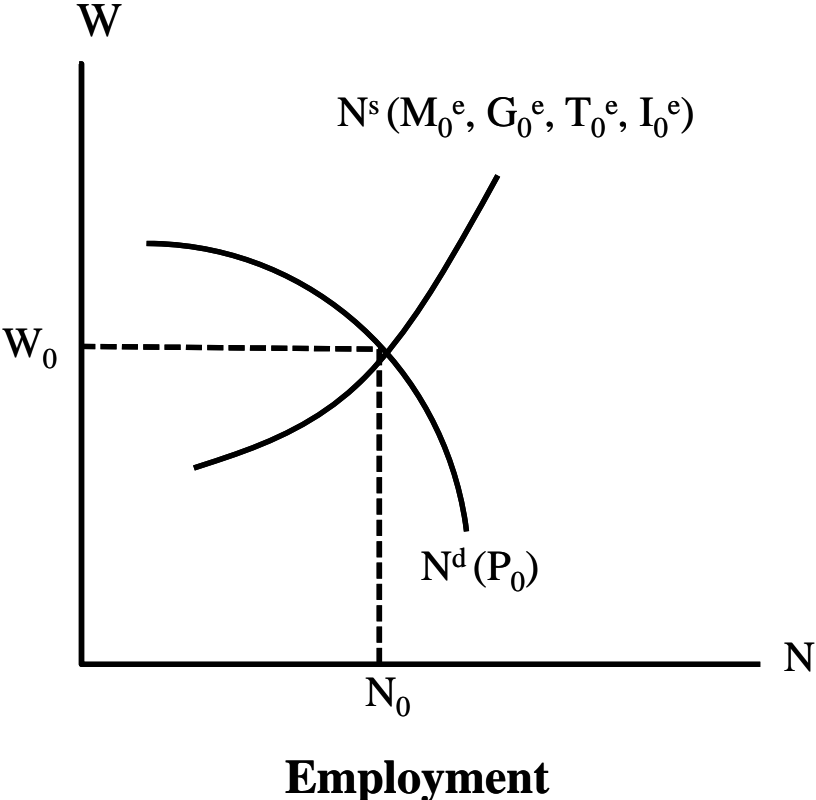
New Keynesian economics

# Output and Employment in the New Classical Model

a. Aggregate Supply and Demand

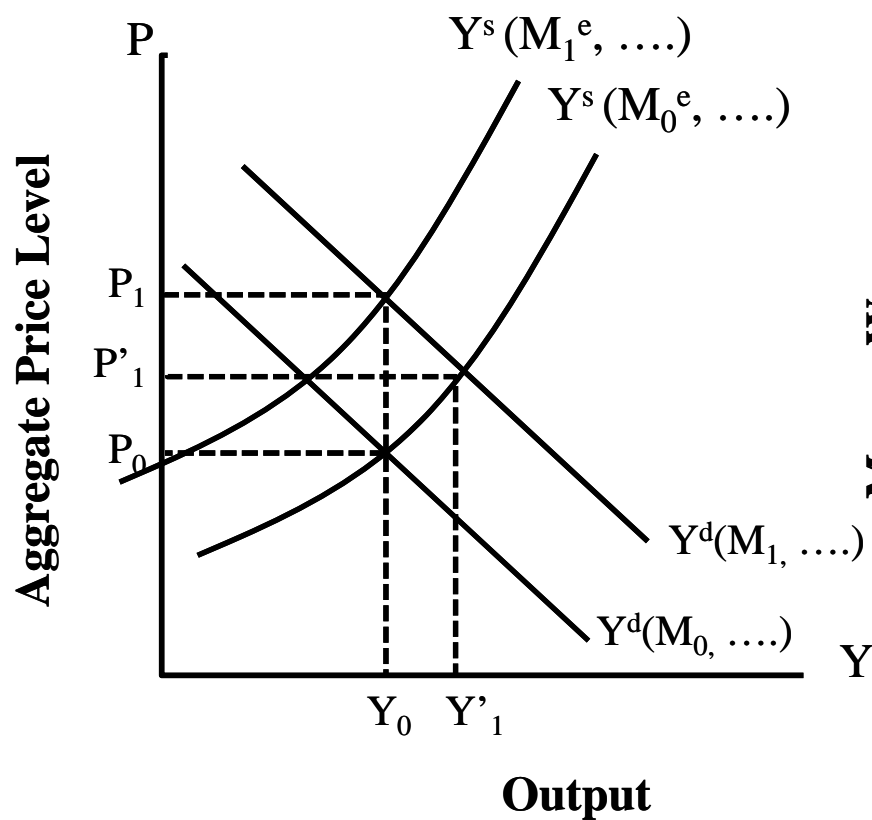


b. Labor Market

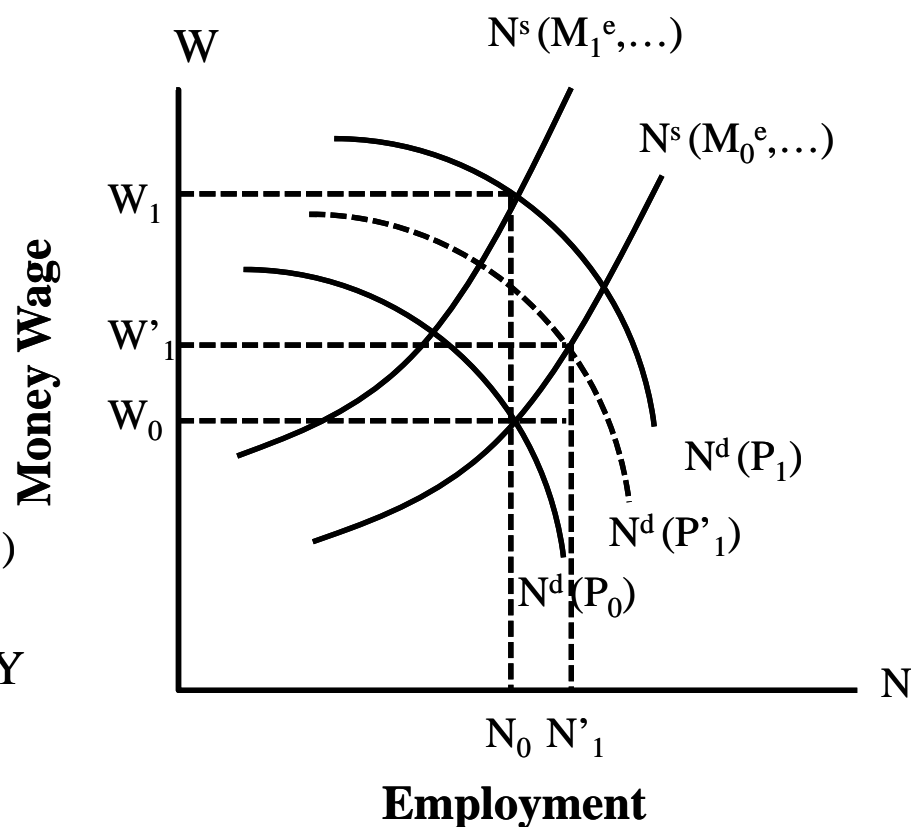


# Effects of an Increase in the Money Supply: The New Classical View

a. Aggregate Supply and Demand

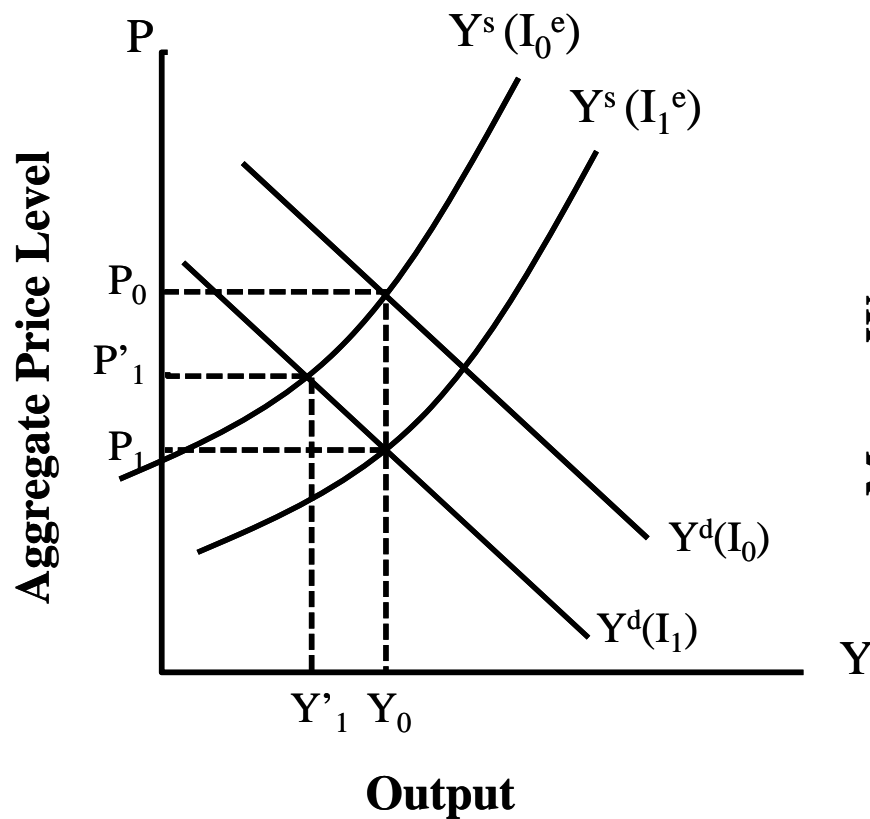


b. Labor Market

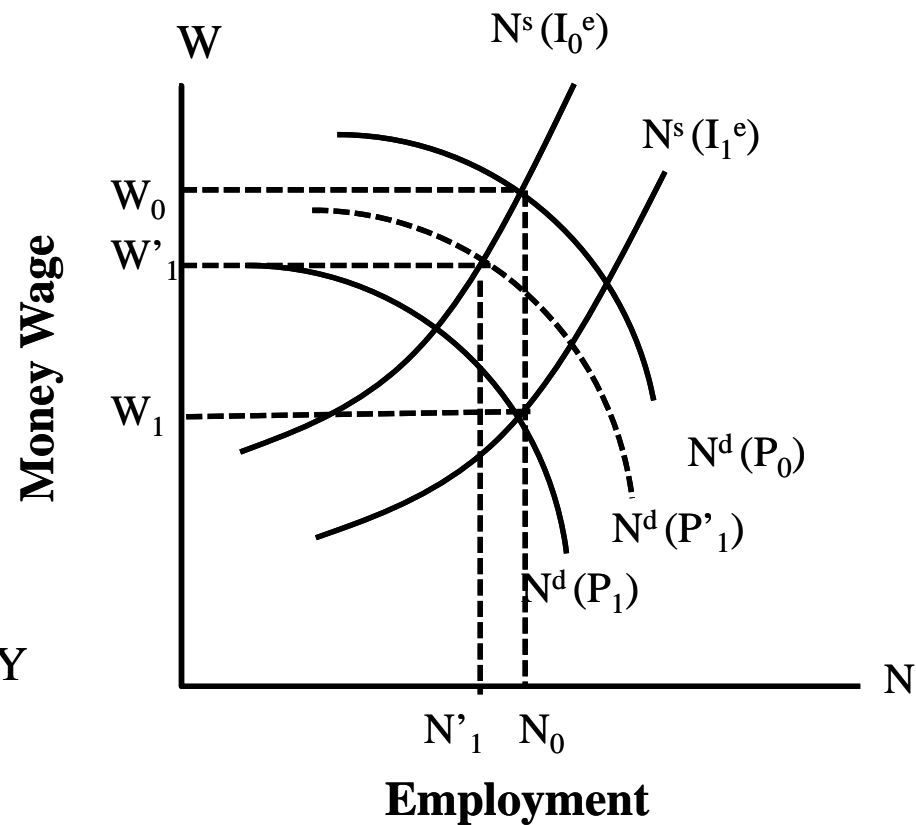


# Effects of An autonomous Decline in Investment: A New Classical Model

a. Aggregate Supply and Demand

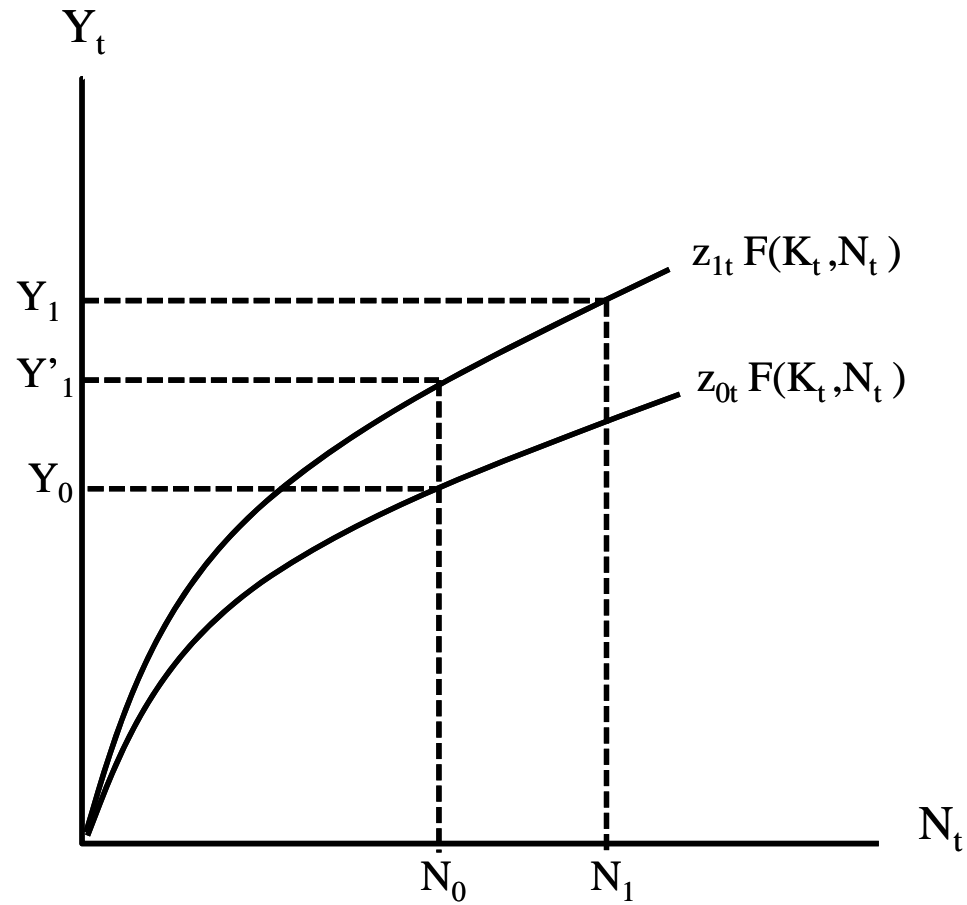


b. Labor Market



# Real Business Cycle Model

# The Effects of a Positive Technology Shock in a Real Business Cycle Model



# New Keynesian Economics:

( Wage and price rigidities are central to Keynes's explanation of involuntary unemployment; need to have explanation based on microeconomic foundation)

- Imperfect competition
- Product price rigidity
- Real rigidity in addition to nominal rigidity

# Three types of New Keynesian models

- 1. Sticky Price model  
(Menu cost model)

Costs of changing prices prevent price adjustments when demand changes.

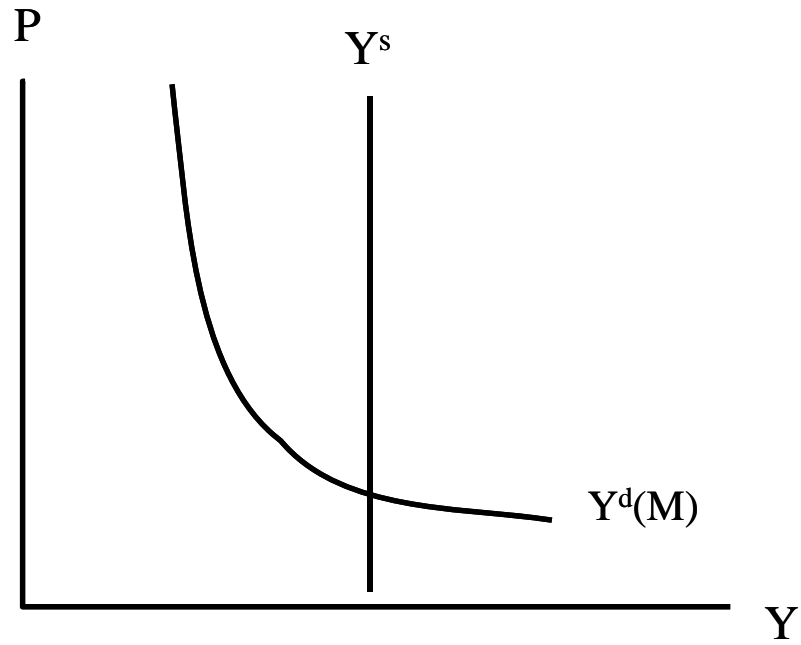
- managerial costs: cost of gathering information required to decide on the optimal price change, cost of communicating to customers who resist the change, etc.
- loss of consumer goodwill
- price reduction may set off competitive rounds of price cuts

- 2. Efficiency wage models
  - Models in which labor productivity depends on the real wage paid to workers
  - Real wage is set to maximize the efficiency units of labor per value of expenditure, not to clear the labor market.
  - Several rationales for the payment of efficiency wages: shirking model, turnover cost model, gift exchange model.

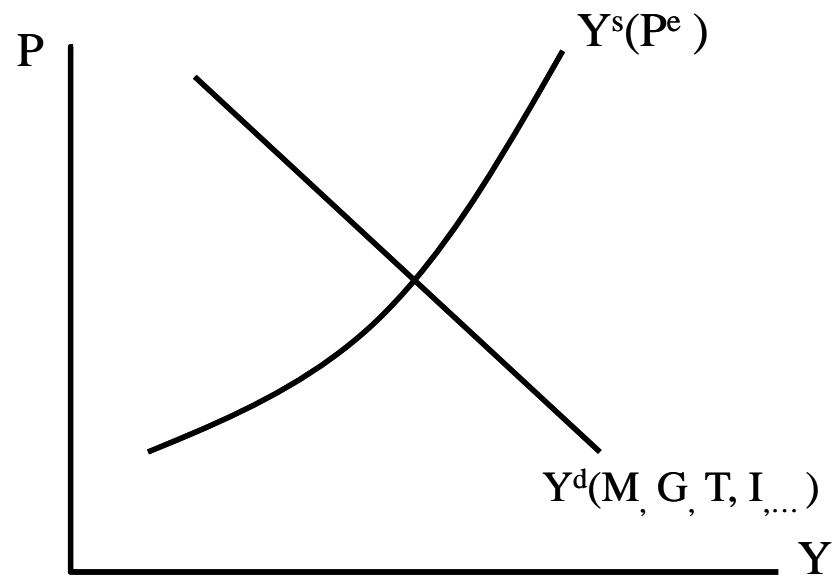
- 3. Insider-Outsider Models
- - provides an explanation for “*unemployment trap*”
- - Union members are “insiders” who have bargaining power with employers because it is costly to replace them with “outsiders” or nonunion members. With a higher real wage. Employment will remain lower than in the pre-recession period.

# **Macroeconomic Models: A Summary**

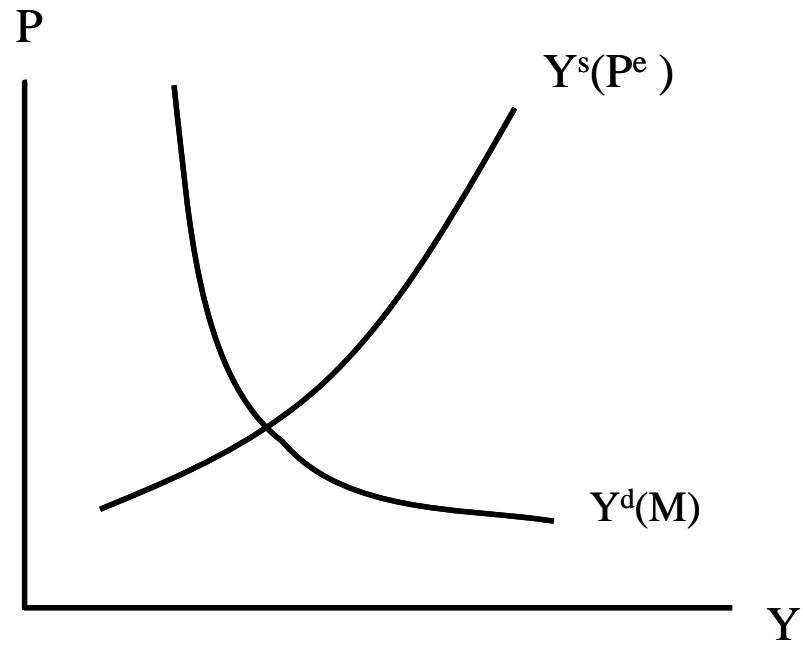
**a. Classical Case**



**b. Keynesian Case**



**c. Monetarist Case**



**d. New Classical Case**

