

Barcelona Macroeconomics Summer School 2014

Labor Markets and Monetary Policy

July 14-18, 2014
Professor Jordi Galí

The course will cover recent research exploring the role of unemployment and wage rigidities in the design of monetary policy. The core of the lectures will focus on a simple modification of the standard New Keynesian model for which a concept of unemployment can be defined. Several applications of the proposed framework will be discussed including:

- (i) construction and analysis of model-based measures of the output gap
- (ii) role of unemployment in the optimal design of monetary policy
- (iii) empirical evidence on the New Keynesian Wage Phillips curve
- (iv) unemployment in an estimated New Keynesian model: Smets-Wouters revisited.

The course will be self-contained, but will take for granted some familiarity with the basic New Keynesian model at the level of chapters 3-6 in Galí, Jordi (2008): *Monetary Policy, Inflation, and the Business Cycle. An Introduction to the New Keynesian Framework*, Princeton University Press (Princeton, NJ).

A list of selected readings is provided below.

Reading List

Galí, Jordi (2011): *Unemployment Fluctuations and Stabilization Policies: A New Keynesian Perspective*, MIT Press (Cambridge, MA).

Galí, Jordi (2011): "The Return of the Wage Phillips Curve," *Journal of the European Economic Association*, vol. 9, issue 3, 436-461.

Galí, Jordi, Frank Smets and Raf Wouters (2012): "Unemployment in an Estimated New Keynesian Model," *NBER Macroeconomics Annual 2011*, 329-360.

Blanchard, Olivier and Lawrence Katz (1999): "Wage Dynamics: Reconciling Theory and Evidence," *American Economic Review*, Vol. 89, No. 2, pp. 69-74

Erceg, Christopher J., Dale W. Henderson, and Andrew T. Levin (2000): "Optimal Monetary Policy with Staggered Wage and Price Contracts," *Journal of Monetary Economics* vol. 46, no. 2, 281-314.

Phillips, A.W. (1958): "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957," *Economica* 25, 283-299.

Smets, Frank, and Rafael Wouters (2003): "An Estimated Dynamic Stochastic General Equilibrium Model of the Euro Area," *Journal of the European Economic Association*, vol 1, no. 5, 1123-1175.

Smets, Frank, and Rafael Wouters (2007): "Shocks and Frictions in US Business Cycles: A Bayesian DSGE Approach," *American Economic Review*, vol 97, no. 3, 586-606.

Galí, Jordi (2013): "Notes for a New Guide to Keynes (I): Wages, Aggregate Demand and Employment," *Journal of the European Economic Association*, 11(5), 973-1003.

Galí, Jordi and Tommaso Monacelli (2013): "Understanding the Gains from Wage Flexibility: The Exchange Rate Connection," mimeo.

Battarai, Saroj, Gauti Eggertsson, and Raphael Schoenle (2012): "Is Increased Price Flexibility Stabilizing? Redux," mimeo.

Campolmi, Alessia (2012): "Which Inflation to Target?: A Small Open Economy with Sticky Wages," *Macroeconomic Dynamics*, 1-30.

Farhi, Emmanuel, Gita Gopinath, and Oleg Itskhoki (2013): "Fiscal Devaluations," mimeo.

Friedman, Milton (1953): "The Case for Flexible Exchange Rates," in M. Friedman, *Essays in Positive Economics*, Chicago University Press (Chicago, IL)

Keynes, John Maynard (1936): *The General Theory of Employment, Interest and Money*, Macmillan, London. (Chapters 1-3)

Schmitt-Grohé, Stephanie and Martín Uribe (2012): "Pegs and Pain," mimeo.

Andrés, Javier, Rafael Domenech, and Javier Ferri (2006): "Price Rigidity and the Volatility of Vacancies and Unemployment," mimeo, Universidad de Valencia.

Blanchard, Olivier J. and Jordi Galí (2010): "Labor Markets and Monetary Policy: A New Keynesian Model with Unemployment," *American Economic Journal: Macroeconomics* 2 (2), 1-30.

Christiano, Lawrence J., Mathias Trabandt, and Karl Walentin (2010): "Involuntary Unemployment and the Business Cycle," NBER WP 15801.

Faia, Ester (2008): "Optimal Monetary Policy Rules in a Model with Labor Market Frictions," *Journal of Economic Dynamics and Control* 32(5), 1600-1621.

Faia, Ester (2009): "Ramsey Monetary Policy with Labor Market Frictions," *Journal of Monetary Economics* 56(4), 570-581.

Galí, Jordi (2010): "Monetary Policy and Unemployment," in B. Friedman and M. Woodford eds. *Handbook of Monetary Economics*, North-Holland (see also NBER WP#15871)

Gertler, Mark, Luca Sala and Antonella Trigari (2008): "An Estimated Monetary DSGE Model with Labor Market Frictions," *Journal of Money, Credit and Banking* 40 (8), 1713-1764.

Krause, Michael, Thomas Lubik (2007): "The (Ir)relevance of Real Wage rigidities in the New Keynesian Model with Search Frictions," *Journal of Monetary Economics*, vol. 54, no.3, 706-727.

Krause, Michael, David López-Salido, and Thomas A. Lubik (2008): "Inflation Dynamics with Search Frictions: A Structural Econometric Analysis," *Journal of Monetary Economics* 55 (5), 892-916.

Ravenna, Federico and Carl Walsh (2011): "Welfare-Based Optimal Monetary Policy with Unemployment and Sticky Prices," *American Economic Journal: Macroeconomics* 3, 130-162.

Svein, Tommy and Lutz Weinke (2008): "New Keynesian Perspectives on Labor Market Dynamics," *Journal of Monetary Economics* 55 (5), 921-930.

Thomas, Carlos (2008): "Search and Matching Frictions and Optimal Monetary Policy," *Journal of Monetary Economics* 55 (5), 936-956.

Trigari, Antonella (2009): "Equilibrium Unemployment, Job Flows, and Inflation Dynamics," *Journal of Money, Credit and Banking* 41 (1), 1-33.

Trigari, Antonella (2006): "The Role of Search Frictions and Bargaining in Inflation Dynamics," mimeo.

Walsh, Carl (2003): "Labor Market Search and Monetary Shocks", in *Elements of Dynamic Macroeconomic Analysis*, S. Altug, J. Chadha and C. Nolan eds.

Walsh, Carl (2005): "Labor Market Search, Sticky Prices, and Interest Rate Rules", *Review of Economic Dynamics*, 8, 829-849

Background Readings: Real Models of Labor Market Flows

Andolfatto, David (1996): "Business Cycles and Labor Market Search," *American Economic Review*, 86-1, 112-132

Gertler, Mark, and Antonella Trigari (2005), "Unemployment Fluctuations with Staggered Nash Wage Bargaining," *Journal of Political Economy* 117 (1), 38-86.

Hall, Robert (2005): "Employment Fluctuations with Equilibrium Wage Stickiness," *American Economic Review* vol. 95, no. 1, 50-64.

Merz, Monica (1995), "Search in the Labor Market and the Real Business Cycle", *Journal of Monetary Economics*, 36, 269-300

Michaillat, Pascal (2012): "Do Matching Frictions Explain Unemployment? Not in Bad Times," *American Economic Review* 102(4), 1721-1750.

Pissarides, Christopher (2000): *Equilibrium Unemployment Theory*, MIT Press.

Shimer, Robert (2005): "The Cyclical Behavior of Equilibrium Unemployment and Vacancies," *American Economic Review* vol. 95, no. 1, 25-49.