LECTURE 18

EXPANDING THE IS-MP FRAMEWORK TO INCLUDE FINANCIAL CRISES
APRIL 2, 2013

I. EXTENDING THE IS-MP MODEL
   A. Introduction
   B. Assumptions
      1. The saving real interest rate and the borrowing real interest rate
      2. How the two interest rates enter the model
      3. The determination of the interest rate differential
      4. The rest of the model
      5. Two comments
   C. Analyzing the Model
      1. How introducing an interest rate differential affects the planned expenditure line
      2. How introducing an interest rate differential affects the IS curve
      3. Another way of showing how introducing an interest rate differential affects the IS curve
      4. The rest of the model: AD-IA revisited

II. APPLICATIONS
   A. A Change in Consumer Confidence and the “Financial Accelerator”
      1. The effects on output and on the saving interest rate
      2. Are the output effects larger or smaller than without financial market imperfections?
      3. The financial accelerator
   B. A Disruption of Financial Markets
      1. Modeling a financial market disruption
      2. The effects on the Keynesian cross
      3. The effects on output and on the saving interest rate
      4. Modeling the macroeconomic effects of a financial crisis
   C. Monetary Policy and Interest Rate Differentials from 2004 to 2009
   D. Implications for Monetary Policy