

Announcements

Some unfinished material from lecture 12

Broad-brush Lessons to take away

Some news

Discuss Scores on midterm

Return Midterms near break time

After Break: open question session

Open Economy

Supply & Demand for Currency: Review PS5 (GSI final review)

Determination of e: SR S&D, LR PPP

Monetary Policy: w/ open economy under flexible vs fixed exchange rate

Speculative Attack: extreme illustration of benefits of flexible exchange rate regime

Some Lessons to Take Away

Rational Decision Maker: MB vs MC
(Benefits vs Costs)

Economic Costs: Include Opportunity Costs
(Explicit *plus implicit*)

Society's Goals: Efficiency & Equity

Maximize Social Surplus AND Redistribute

(FB: goals should satisfy cost-benefit criterion)

Some Lessons to Take Away

Tradeoffs: Winners and Losers
autarky vs free trade
free market vs rent control
free market vs minimum wage
free market vs tax (distortion /DWL)

Pareto Improvement: can make someone better off and leave others just as well off (seek out!)
Bargain under externality

Pareto Efficient: No way to make one better off without making other lose

Some Lessons to Take Away

PC Markets: Free market max social surplus. In LR $p = \min AC = \min$ unit cost. Incentive for cost-saving innovation: p keeps falling!!

Monopoly Market: Free market does not max "social surplus" (bad). Gives incentive for new product inventions (good). Eg. Ulcer drug.

Free Markets Not Panacea: May Not reach social optimum
Externality (positive & negative)
Public Good (may get under-provision)
Asymmetric Information (Lemons Model)

Some Lessons to Take Away

Standard of Living: Real GDP per capita imperfect but good measure of well-being/standard of living. Improves with APL, which improves with human, physical and technology.

Potential Real GDP: grows over time. Actual real GDP subject to cycles, sometimes above, sometimes below potential

Output Gaps: Costly due to excess unemployment and inflation. Why we need to measure these carefully.

Some Lessons to Take Away

Stabilization Policy: Monetary and Fiscal policy actions can close the gap in SR. Especially useful if gaps are large or particularly persistent. When costs of gaps are high, remove quickly.

Effectiveness of Policy: Fiscal subject to legislative bugs. Monetary policy depends on relation of real interest rate target to all real interest rates. Monetary policy more effective with open economy and flexible exchange rate regime.

Using Economics 1

Understanding Policy Decisions: Informed Voter

Understanding News: as voter, as student, as worker, as policy maker (as decision-maker)

Springboard: More Economics!

Or, Combine with ideas in other fields.
Eg. psych, polisci, bio, engineering, you name it!

In the News

Bernanke's Speech (disinflation vs deflation)

Recent 2.4% GDP growth: U.S.
Business Spending

Unemployment fell from 6.4 to 6.2%
(discouraged workers)

US: Deflation vs Disinflation

Early 2003 : Greenspan says deflation in works; FED may use nontrad means ie buy long term bonds, expect P inc, r (yield) fall, public massive buy bonds now (hold & sell later!)

Later 2003: Greenspan (won't need to use nontrad means, "inflation" likely, r to inc, P fall) Massive selloff of bonds now, yield inc (r inc) now!! Before recovery. See S. Liesman, WSJ (7/25).

Bernanke Follow-up Speech

Bond market overreacted.

Disinflation likely. Inflation overestimated (CPI)
Slack more than measured (AD lower)

Deflation vs Disinflation
Doesn't allow wiggle room for monetary policy

Deflation: neg inflation plus already low nominal rate means inc r, means contractionary monetary pol!!! During recessionary gap!!

Midterm 2 Results

Average: 72
Median: 76
SD: 19

Max scores: 99,99,100,101! Great job!

A work: 86 & above
B work: 70 to 85
C work : 48 to 69

A/B/C Level Work

A: could miss part c stabilizer, part b Keynes & monetary policy, part b Bond&P&r, 2001 recession

B:

C : Part a Keynes& monetary policy, Keynes & fiscal policy,T/F/U, National savings

Open Questions After Break

Questions

Return Midterms