

## Kiel Institute Advanced Studies Program 2003

### Monetary Policy: Theory and Practice

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The lectures will provide an overview of the recent literature on optimizing sticky price models, their associated inflation dynamics, and their implications for monetary policy. Lecture notes will be handed out during the course. A list of topics covered, together with a basic reading list with some of the key articles for each topic is provided below.

#### A Framework for Monetary Policy Analysis

Woodford, Michael (2002): "A Neo-Wicksellian Framework for the Analysis of Monetary Policy," forthcoming as chapter 4 in *Interest and Prices: Foundations of a Theory of Monetary Policy*, Princeton University Press.

Yun, Tack (1996): "Nominal Price Rigidity, Money Supply Endogeneity, and Business Cycles," *Journal of Monetary Economics* 37, 345-370.

King, Robert G., and Alexander L. Wolman (1996): "Inflation Targeting in a St. Louis Model of the 21st Century," *Federal Reserve Bank of St. Louis Review*, vol. 78, no. 3. (NBER WP #5507).

Dotsey, Michael, Robert G. King, and Alexander L. Wolman (1999): "State Dependent Pricing and the General Equilibrium Dynamics of Money and Output," *Quarterly Journal of Economics*, vol. CXIV, issue 2, 655-690.

#### Monetary Policy Design (I): A Baseline Model

Galí, Jordi (2003): "New Perspectives on Monetary Policy, Inflation, and the Business Cycle," in *Advances in Economics and Econometrics*, volume III, edited by M. Dewatripont, L. Hansen, and S. Turnovsky, Cambridge University Press (also available as NBER WP #8767).

Woodford, Michael (2002): "Inflation Stabilization and Welfare," forthcoming as chapter 6 in *Interest and Prices: Foundations of a Theory of Monetary Policy*, Princeton University Press.

Clarida, Richard, Jordi Galí, and Mark Gertler (1999): "The Science of Monetary Policy: A New Keynesian Perspective," *Journal of Economic Literature*, vol. 37, no. 4, 1661-1707.

Woodford, Michael (2001): "The Taylor Rule and Optimal Monetary Policy," *American Economic Review* 91(2): 232-237 (2001).

Rotemberg, Julio and Michael Woodford (1999): "Interest Rate Rules in an Estimated Sticky Price Model," in J.B. Taylor ed., *Monetary Policy Rules*, University of Chicago Press.

Galí, Jordi, J. David López-Salido, and Javier Vallés (2003): "Technology Shocks and Monetary Policy: Assessing the Fed's Performance," *Journal of Monetary Economics*, vol. 50, no. 4., 723-743.

Bullard, James, and Kaushik Mitra (2002): “Learning About Monetary Policy Rules,” *Journal of Monetary Economics*, vol. 49, no. 6, 1105-1130.

Benhabib, Jess, Stephanie Schmitt-Grohe, and Martin Uribe (2001): “The Perils of Taylor Rules,” *Journal of Economic Theory* 96, 40-69.

Levin, Andrew, Volker Wieland, and John C. Williams (2003): “The Performance of Forecast-Based Monetary Policy Rules under Model Uncertainty,” *American Economic Review*, forthcoming.

Blanchard, Olivier and Charles Kahn (1980), “The Solution of Linear Difference Models under Rational Expectations”, *Econometrica*, 48, 1305-1311

Clarida, Richard, Jordi Galí, and Mark Gertler (2000): “Monetary Policy Rules and Macroeconomic Stability: Evidence and Some Theory,” *Quarterly Journal of Economics*, vol. 105, issue 1, 147-180.

Taylor, John B. (1998): “An Historical Analysis of Monetary Policy Rules,” in J.B. Taylor ed., *Monetary Policy Rules*, University of Chicago Press.

Orphanides, Athanasios (1999): “The Quest for Prosperity Without Inflation” European Central Bank WP#15.

## **Monetary Policy Design (II): Extensions**

### *a. Sticky Wages*

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.

### *b. Open Economy*

Galí, Jordi, and Tommaso Monacelli (2002): “Monetary Policy and Exchange Rate Volatility in a Small Open Economy Model,” NBER WP#8905

Clarida, Richard, Jordi Galí, and Mark Gertler (2001): “Optimal Monetary Policy in Open vs. Closed Economies: An Integrated Approach,” *American Economic Review*, vol. 91, no. 2, 248-252.

Clarida, Richard, Jordi Galí, and Mark Gertler (2002): “A Simple Framework for International Monetary Policy Analysis,” *Journal of Monetary Economics*, vol. 49, no. 5, 879-904.

### *c. Monetary and Fiscal Distortions*

Woodford, Michael (1999): “Optimal Monetary Policy Inertia,” NBER WP #7261.

Khan, Aubhik, Robert G. King and Alexander L. Wolman (2002): “Optimal Monetary Policy,” NBER WP#9402

Schmitt-Grohé, Stephanie, and Martin Uribe (2002): “Optimal Fiscal and Monetary Policy under Sticky Prices,” NBER WP# 9220

## **The Zero Bound Problem and the Risk of Deflation**

Ahearne, Alan et al. (2002): “Preventing Deflation: Lesson’s from Japan’s Experiences in the Nineties,” Federal Reserve Board, International Finance Discussion Papers #729, June 2002.

Krugman, Paul (1998): "It's Baaaack: Japan's Slump and the Return of the Liquidity Trap," *Brookings Papers on Economic Activity*, vol. 2, 137-187

Eggertson, Gauti, and Michael Woodford (2003): "The Zero Bound on Interest Rates and Optimal Monetary Policy," mimeo

Coenen, Günter, and Volker Wieland (2002): "The Zero-Interest-Rate Bound and the Role of the Exchange Rate for Monetary Policy in Japan," mimeo.

Orphanides, Athanasios, and Volker Wieland (2000): "Efficient Monetary Policy Design Near Price Stability," *Journal of the Japanese and International Economies*, 14, 327-365.

McCallum, Bennet T. (2000): "Theoretical Analysis regarding a Zero Lower Bound on Nominal Interest Rates," *Journal of Money, Credit and Banking*, 32, 870-904.

Svensson, Lars E.O. (2001): "The Zero Bound in an Open Economy: A Foolproof Way of Escaping from a Liquidity Trap," *Monetary and Economic Studies*, February, 277-312.

Svensson, Lars E.O. (2002): "Escaping from a Liquidity Trap and Deflation: the Foolproof Way and Others," Princeton University, mimeo.

Fuhrer, Jeffrey C. and Brian F. Madigan (1997): "Monetary Policy when Interest Rates are Bounded at Zero," *Review of Economics and Statistics*, 79, 573-585

### **Inflation Dynamics: Theory and Evidence**

Fuhrer, Jeffrey C., and George R. Moore, 1995a, "Inflation Persistence", *Quarterly Journal of Economics*, No. 440, February, pp 127-159.

Mankiw, N. Gregory and Ricardo Reis (2002): "Sticky Information vs. Sticky Prices: A Proposal to Replace the New Keynesian Phillips Curve," *Quarterly Journal of Economics*, vol. CXVII, issue 4, 1295-1328.

Sbordone, Argia (2002): "Prices and Unit Labor Costs: Testing Models of Pricing Behavior," *Journal of Monetary Economics*, vol. 45, no. 2, 265-292.

Gali, Jordi and Mark Gertler (1998): "Inflation Dynamics: A Structural Econometric Analysis," *Journal of Monetary Economics*, vol 44, no. 2, 195-222.

Gali, Jordi, Mark Gertler, David López-Salido (2001): "European Inflation Dynamics," *European Economic Review* vol. 45, no. 7, 1237-1270.

Gali, Jordi, Mark Gertler, David López-Salido (2003): "Robustness of the Estimates of the Hybrid New Keynesian Phillips Curve," mimeo.

Eichenbaum, Martin and Jonas D.M. Fisher (2003): "Testing the Calvo Model of Sticky Prices," mimeo.

Christiano, Lawrence J., Martin Eichenbaum, and Charles L. Evans (2001): "Nominal Rigidities and the Dynamic Effects of a Shock to Monetary Policy," NBER WP#8403.

Smets, Frank, and Raf Wouters (2002): "An Estimated Dynamic Stochastic General Equilibrium Model of the Euro Area," *Journal of the European Economic Association*, forthcoming.

Erceg, Christopher, and Andrew Levin (2003): "Imperfect Credibility and Inflation Persistence," *Journal of Monetary Economics*, vol. 50, no. 4., 915-944.