

Econ 2: Announcements

- ▶ Test 4 on Monday: Chapters 11, 13 (plus material covered in lecture)
- ▶ Review session: Friday, 6-8pm, Media Theater
- ▶ MSI review for Test 4: Friday March 7, 5-7 PM ARC 203.
- ▶ Problem set 5 will be available on the class web site.
- ▶ See lecture from March 5th for grading scale.
- ▶ Next week – chapters 15 and 21. You do not need to read chapter 20, but I will cover some of the material from that chapter in lecture.

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Winter 2008

Econ 2: Lecture outline

- ▶ Using the ADI curve.
- ▶ Using macroeconomic policy

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Old and New Macroeconomic Policy Trade-offs

- ▶ Old trade-off: the Phillips curve
 - ▶ Policy can lower unemployment but increase average inflation.
 - ▶ If inflation is seen as very costly then policy actions will result in higher unemployment.
 - ▶ If unemployment is seen as very costly then policy actions will result in higher inflation.
- ▶ In the 1970s a recognition that $U < U^*$ cannot be sustained
 - ▶ Unemployment returns to the natural rate in the long run.
 - ▶ Choice is between lower or higher inflation in the long run.

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Old and New Macroeconomic Policy Trade-offs

▶ New trade-off: Output stability vs. Inflation stability

▶ John Taylor:

- ▶ Attempts to stabilize output lead to greater fluctuations in inflation.
- ▶ Attempts to stabilize inflation lead to greater fluctuations in output.
- ▶ If policymakers focus too much on stabilizing inflation they get undesirable fluctuations in output and employment.
- ▶ Policymakers face a trade-off between stability in the real economy or inflation.
- ▶ Policymakers should focus on stabilizing the economy, and not on achieving a particular output or inflation outcome.
