















The Baseline NK Model Some SIMPLE ANALYSIS New Keynesian Phillips Curve/Aggregate Supply Curve $\hat{\pi}_t = \beta E_t \hat{\pi}_{t+1} + \kappa \hat{y}_t + \boldsymbol{u}_t$ AS slopes upwards $\partial \hat{\pi}_t / \partial \hat{y}_t > 0$ Higher expected future inflation shifts AS outwards Interpretation: the expectations of future inflation that policy-makers induce have an effect on the period-*t* equilibrium Expectations missing in "old" Phillips Curve/AS-AD frameworks Current inflation a function of all future output gaps and cost-push shocks (recursively substitute for π_t) October 18, 2011 9

	The Baseline NK Model
Sc	OME SIMPLE ANALYSIS
	New Keynesian Phillips Curve/Aggregate Supply Curve
	$\hat{\pi}_t = \beta E_t \hat{\pi}_{t+1} + \kappa \hat{y}_t + \boldsymbol{u}_t$
	AS slopes upwards $\partial \hat{\pi}_{\cdot} / \partial \hat{v}_{\cdot} > 0$
	 Higher expected future inflation shifts AS outwards Interpretation: the expectations of future inflation that policy-makers induce have an effect on the period-t equilibrium Expectations missing in "old" Phillips Curve (ASAD frameworks)
	Current inflation a function of all future output gaps and cost-push shocks (recursively substitute for n_t)
□ an even a < 0 !!!	Reference empirical value(s) of κ: anywhere from ≈ 0.05 (Sbordone 2002 JME) to ≈ 0.3 (Roberts 1995 JMCB) The outlier Sensitive to whether mc ≈ y Sensitive to precise empirical measure of mc "Unit labor cost" (i.e., w/mpn) the correct theoretical measurebut what does "unit labor cost" in the data mean?
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The Baseline NK Mod
ME SIMPLE ANALYSIS
New Keynesian IS Curve/Aggregate Demand Curve
$\hat{y}_{t} = -\frac{1}{\sigma} \Big[\hat{R}_{t} - E_{t} \hat{\pi}_{t+1} \Big] + E_{t} \hat{y}_{t+1} + g_{t}$
AD slopes downwards with respect to ex-ante real interest rate
Higher expected future output shifts AD outwards Consumption-smoothing foundation
Current output (gap) a function of all future real interest rates, which depend on expected policy and expected inflation (recursively substitute for y_t)
Reference value of σ : 1 (borrowed from RBC models)
What "determines" policy?



	The Baseline NK Model
Мо	NETARY POLICY
	To "close" the model, need to specify how policy is set
	Taylor Rule (or variants of) the most common
	$\hat{R}_{t} = \delta_{\pi} \hat{\pi}_{t} + \delta_{y} \hat{y}_{t}$
	First described by Taylor (1993) as both a positive and normative "rule"
	With appropriate coefficients, describes reasonably well the behavior of U.S. (and other countries') monetary policy
	Taylor's coefficients: $\delta_n = 1.5$, $\delta_y = 0.5$
	Taylor Principle: $\delta_n > 1$ required for "good policy"
Davig and er (2006) for an view	Basic idea: $\delta_n > 1$ ensures real interest rate rises more than one-for-one with a rise in inflation – the "dampening" effect on AD lowers inflation
	Empirical evidence: $\delta_n < 1$ pre-Volcker, $\delta_n > 1$ Volcker/Greenspan
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	NK Models of the Future?
Or	NGOING/FUTURE RESEARCH
	State-dependent pricing
	 Endogenize when firms re-set nominal price: Dotsey, King, Wolman (1999 QJE), Dotsey and King (2005 JME), Golosov and Lucas (2007 JPE)
	Coordination frictions in key markets
	Labor market frictions: already many papers: Krause and Lubik (2007 JME), Blanchard and Gali (2010 AEJ:Macro), Ravenna and Walsh (2010 AEJ:Macro), many others
	Capital market frictions: "financial accelerator" of Bernanke, Gertler, and Gilchrist (1999)
	Goods market frictions: whether to motivate money primitively (money search) or simply an articulation of the time goods markets trades take
	Heterogeneity
	Redistributional aspects of (long-run and short-run) monetary policy?
	Behavioral economics/norms
	□ Akerlof (2007 <i>AER</i>)
	Financial frictions
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