
ADVANCED MACROECONOMICS II

PART I

SOMMERSEMESTER 2005

Tuesdays and Thursdays, 10:15-11:45, Room 120B

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Course Objective

This course is intended for PhD students, either in the PhD Program in Economics or in Graduiertenkolleg. This first part of the PhD course puts an emphasis on topics in the interaction of modern macroeconomics and financial economics, namely consumption, saving, portfolio choice, credit market imperfections, asset pricing, and money demand. The course is designed to introduce important concepts, results, and state-of-the-art modeling approaches that can prepare students for cutting-edge doctoral research in these areas.

The reading list that follows is extensive, and is intended as a guide to all students, from those interested in understanding basic concepts to those with a serious research interest in these topics. Nobody should expect (or be expected) to read all items. Starred items are more strongly recommended. When reading articles, you should focus on the big picture rather than on the details of each paper. You can later revisit details if you decide to pursue a particular research topic. Taking good lecture notes and studying the main readings is critical. Macroeconomics needs not only to be read but also to be digested and synthesized. Those who study their notes and read extensively, well in advance of the exam, are bound to profit most.

Assessment

The grade for this Part will be based on an exam that is scheduled to be held on

Thursday, June 2, 2005

During the course, students will be given problem sets that they need to submit to the instructor one week later. Handing in problem sets is a course requirement, even if

they are not graded. (Please keep photocopies prior to submitting your answers, to help you with your exam review). Brief answers to problem sets will be provided either in class or in handouts. Discussion of course material and problems with your fellow students is a good idea, as it can help towards preparation for the final exam. However, each student is responsible for producing and writing up his or her own answers to the problems. Mindless copying of problem solutions from each other defeats the purpose of preparing for the exam, let alone of learning!

Textbooks

1. *Lars Ljungqvist and Thomas J. Sargent, *Recursive Macroeconomic Theory*, M.I.T. Press (2000 or 2004). References below are to the 2000 edition (with references to 2004 in parentheses). **Required Text.**
2. Olivier J. Blanchard and S. Fischer, *Lectures in Macroeconomics*, M.I.T. Press (1989).
3. Thomas J. Sargent, *Dynamic Macroeconomic Theory*, Harvard University Press (1987).

Useful Supplemental Reading

1. David Romer, *Advanced Macroeconomics*, McGraw-Hill Publishers.
2. Guiso, Luigi, Michael Haliassos and Tullio Jappelli (Eds.), *Household Portfolios*, MIT Press (2002).
3. Angus Deaton, *Understanding Consumption*, Oxford University Press, 1992.
4. Christian Gollier, *The Economics of Risk and Time*, MIT Press, 2001.
5. Guiso, Luigi, Michael Haliassos, and Tullio Jappelli (Editors), *Stockholding in Europe*, Palgrave Macmillan Press, 2002.
6. Nancy L. Stokey and Robert Lucas with Edward Prescott, *Recursive Methods in Economic Dynamics*, Harvard University Press, 1989.
7. Kenneth Judd, *Numerical Methods in Economics*, MIT Press, 1998.
8. John Taylor and Michael Woodford (Editors), *Handbook of Macroeconomics*, Amsterdam: North Holland, 2000.
9. Benjamin Friedman and Frank Hahn (Eds.), *Handbook of Monetary Economics*, North-Holland Publishing Company, 1990.

Recommended Bibliography by Topic

1. Consumption, Saving, and Borrowing Constraints Under Background Income Risk

A. Classics

Friedman, Milton. 1957, *A Theory of the Consumption Function*, Princeton, NJ: Princeton University Press.

Leland, Hayne, 1968, Saving and uncertainty: The precautionary demand for saving, *Quarterly Journal of Economics*, 82, 456-73.

Sandmo, Agnar, 1970, The effect of uncertainty on saving decisions, *Review of Economic Studies*, 37, 353-60.

B. Surveys and Overviews

*Blanchard-Fischer, *Lectures*, chapter 6.

Deaton, Angus, 1992, *Understanding Consumption*, Oxford University Press.

Attanasio, Orazio, 2000, Consumption, in John Taylor and Michael Woodford (Editors), *Handbook of Macroeconomics*, Amsterdam: North Holland.

Sargent and Ljungqvist, Chapter 14 (17 in 2004 edition).

Romer, *Advanced Macroeconomics*, Chapter 7.

C. Precautionary Saving

*Kimball, Miles, 1991, Precautionary motives for holding assets, Newman, P., M. Milgate, and John Eatwell (Eds.), *The new Palgrave dictionary of money and finance*: 3, 158-61.

Kimball, Miles, 1990, Precautionary saving in the small and in the large, *Econometrica*, 58, 53-73.

*Zeldes, Steven, 1989, Optimal consumption with stochastic income: Deviations from certainty equivalence, *Quarterly Journal of Economics*, 275-98.

*Carroll, Chris, 1997, Buffer Stock Saving and the Permanent Income Hypothesis, *Quarterly Journal of Economics*, 112, 1-56.

Gourinchas, Pierre O. and Jonathan Parker, 2002, Consumption over the life cycle, *Econometrica*, 70, 47-89.

Hubbard, R. Glenn, Jonathan Skinner, and Steven Zeldes, 1994, The importance of precautionary motives in explaining individual and aggregate saving, *Carnegie-Rochester Conference Series on Public Policy*, 40, 59-125.

*Guiso, Luigi, Tullio Jappelli, and Daniele Terlizzese, 1992, Earnings uncertainty and precautionary saving, *Journal of Monetary Economics*, 30, 307-21.

Carroll, Christopher and Andrew Samwick. 1997, The Nature of Precautionary Wealth, *Journal of Monetary Economics*, 40(1).

D. Borrowing Constraints

- *Deaton, Angus, 1991, Saving and liquidity constraints, *Econometrica*, 59, 1221-48.
- *Hall, Robert, 1978, Stochastic implications of the life cycle-permanent income hypothesis: Theory and evidence, *Journal of Political Economy*, σελ. 971-87.
- Flavin, Marjorie. 1981, The Adjustment of Consumption to Changing Expectations About Future Income, *Journal of Political Economy*, 89, 974-1009.
- Campbell, John Y., and N. Gregory Mankiw, 1989, Consumption, Income and Interest Rates: Reinterpreting the Time Series Evidence, in Olivier J. Blanchard and Stanley Fischer (Eds.), *NBER Macroeconomics Annual*, 1989, Cambridge, Mass, MIT Press, 185-216.
- *Zeldes, Steven, 1989, Consumption and liquidity constraints: An empirical investigation, *Journal of Political Economy*, 305-46.

2. Household Portfolio Choice

- *Michael Haliassos, "Stockholding: Lessons from Theory and Computations", in L. Guiso, M. Haliassos, and T. Jappelli (Eds), *Stockholding in Europe*, Palgrave Macmillan Press, 30-51.
- *Haliassos, Michael and Carol C. Bertaut, 1995, Why do so few hold stocks?, *The Economic Journal*, 105, 1110-1129.
- *Michael Haliassos and Alexander Michaelides, "Portfolio Choice and Liquidity Constraints", *International Economic Review*, 44, 2003, pp. 143-78.
- *Heaton John, and Deborah Lucas, 2000, Portfolio choice in the presence of background risk, *The Economic Journal*, 109, 1-26.
- *Cocco, J.F., F.J. Gomes, and P.J. Maenhout, 1999, Consumption and portfolio choice over the life-cycle, forthcoming in the *Review of Financial Studies*.
- Gollier, Christian, 2000, What Does Theory Have to Say about Household Portfolio Choice? In L. Guiso, M. Haliassos, and T. Jappelli (Editors), *Household Portfolios*, Cambridge: MIT Press, 2001.
- Viceira, Luis, 2001, Optimal portfolio choice for long-horizon investors with nontradable labor income, *Journal of Finance*, 56, 433-70.
- Miniaci, Raffaele and Guglielmo Weber, 2000, Econometric Issues in the Estimation of Household Portfolio Models. In L. Guiso, M. Haliassos, and T. Jappelli (Editors), *Household Portfolios*, Cambridge: MIT Press, 2001.
- Haliassos, Michael and Alexander Michaelides, Calibration and Computation of Household Portfolio Models. In L. Guiso, M. Haliassos, and T. Jappelli (Editors), *Household Portfolios*, Cambridge: MIT Press, 2001.
- Vissing-Jorgensen, Annette, 1999, Towards an explanation of household portfolio choice heterogeneity: Nonfinancial income and participation cost structures, mimeo, University of Chicago.
- Luigi Guiso, Michael Haliassos, and Tullio Jappelli, "Household Stockholding in Europe: Where Do We Stand, Where Do We Go?", *Economic Policy*, April 2003, 117-164.

5. Asset Pricing

A. Capital Asset Pricing Model (CAPM)

*Huang and Litzenberger, 1988, *Foundations for Financial Economics*, ch. 3-4.

Merton, Robert, 1973, An intertemporal capital asset pricing model, *Econometrica*, 41, 867-87.

Cochrane, John, 2001, *Asset Pricing*.

B. Consumption Capital Asset Pricing Model (CCAPM):

*Blanchard-Fischer, *Lectures*, ch. 10.1.

*Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, ch. 10 (in both editions).

Breeden, Douglas, 1979, An intertemporal asset pricing model with stochastic consumption and investment, *Journal of Financial Economics*, 7, 265-96.

Mankiw, Gregory and Matthew Shapiro, 1986, Risk and return: Consumption versus market beta, *Review of Economics and Statistics*, 68, 452-9.

C. The Equity Premium Puzzle

Mehra, Rajnish and Edward Prescott, 1985, The equity premium: A puzzle, *Journal of Monetary Economics*, 15, 145-61.

*Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, ch. 10 (in both editions).

*Kocherlakota, Narayana, 1996, The Elusive Puzzle of the Equity Premium, *Journal of Economic Literature*, March.

Constantinides, George, Bruce Donaldson and Rajnish Mehra, 2002, Junior can't borrow: A new perspective on the equity premium puzzle, *Quarterly Journal of Economics*.

Weil, Philippe, 1989, The equity premium puzzle and the riskfree rate puzzle, *Journal of Monetary Economics*, 24, 401-21.

Mankiw, Gregory and Stephen Zeldes, 1991, The consumption of stockholders and nonstockholders, *Journal of Financial Economics*, 29, 97-112.

6. Demand for Money

Tobin-Baumol-Allais Model of Transactions Demand

*Tobin, James, 1956, The interest elasticity of the transactions demand for cash, *Review of Economics and Statistics*, 38, 241-47.

Blanchard and Fischer, Chapter 4.3.

Overlapping Generations with Fiat Currency

Samuelson, Paul, 1958, An exact consumption-loan model of interest with and without the social contrivance of money, *Journal of Political Economy*, 66, 467-82.

*Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, ch. 8 (in both editions).

*Sargent, *Dynamic Macro*, Chapter 7

Blanchard-Fischer, *Lectures*, ch. 3, 4.1.

Cash in advance Models

*Sargent, *Dynamic Macro*, Chapter 5

Search Models of Money

*Kiyotaki, Nobuhiro and Randall Wright, 1993. “A Search-theoretic Approach to Monetary Economics”, *American Economic Review*, 83, 63-77.

Peter Rupert, Martin Schindler, Randall Wright, 2001. “Generalized Search-Theoretic Models of Monetary Exchange”, *Journal of Monetary Economics*, 48, 605–622.