

Why Macro/Finance Models?

- Many events involve both macro and finance.
 - Collapse of output and employment in US Great Recession, 2008-?, involved the financial sector in a fundamental way.
- Policy questions frequently require integrating macro and finance.
 - Will an exchange rate depreciation stimulate or hurt economic activity?
 - Stimulate: by cheapening currency, encourage more foreigners and domestic residents to shift demand to domestic economy.
 - Hurt: by cheapening currency, domestic borrowers in foreign currency suffer a capital loss. To the extent that this hurts their balance sheets, this causes them to cut back on spending, reducing demand in domestic economy.
- So, to address even an apparently simple question like what is the effect of a currency depreciation:
 - Must have a good sense of how goods markets work, how financial markets work, and how they all interact.
 - Only way to think about all these things simultaneously requires model.
 - Must know macro and micro. Must know econometrics, to evaluate and assign values to model parameters.