Formulation, Estimation and Policy Analysis with DSGE Models with Financial Frictions

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Objectives of Lectures

- Foundations of basic New Keynesian (NK) model.

- Introduction of financial frictions into NK model.
  - Basic theory.
  - Make sense of the idea that financial markets can be 'dysfunctional' and large scale government asset purchases might fix the problem.
  - Empirical DSGE analysis: interaction of a 'risk' shock with financial system appears to account for a substantial fraction of economic fluctuations.

- Implications of zero lower bound on interest rate.
  - Highlights the idea of 'insufficient' aggregate demand.

Afternoon sessions

- Hands-on experience solving, analyzing and estimating DSGE models.
  - Lecture on Bayesian econometrics.

- Substantive questions related to lectures:
  - Dynamics of the NK model and persistence of shocks
    - ‘insufficient aggregate demand’, ‘excessive aggregate demand’

  - Rationale for Taylor principle

  - Possible pitfalls of Taylor principle
    - Substantial working capital channel.
    - News shocks and monetary policy/stock market volatility connection.