

# Financial Frictions and the Macroeconomy

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# Outline of Morning Lectures

- Take the baseline New Keynesian model as given.
- Most influential model of financial frictions in DSGE models at this point: *Costly State Verification* model
  - Careful discussion of microeconomics of model.
  - Quantitative impact of integrating CSV into New Keynesian DSGE model.
- Two other models of financial frictions, based on moral hazard (maybe a third, based on adverse selection).
- A different type of financial market friction: zero lower bound on nominal rate of interest.
  - Dangers for the economy.
  - Policy responses (will look at government spending and other responses).

# Afternoon Sessions

- Computational and econometric tools for analysis of DSGE models.
  - ‘homework’ 7 and 9.
- Substantive issues:
  - Taylor principle as a guide to implementing inflation targeting: pros and cons.
  - Monetary policy and asset price volatility.