

The Future of Macroeconomics

A Discussion of a paper by John Muellbauer
Prepared for the ECB Colloquium in Honour of Vítor Constâncio
By
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University of Warwick and NIESR, Wednesday 16th May 2018

Three Themes of John's Paper

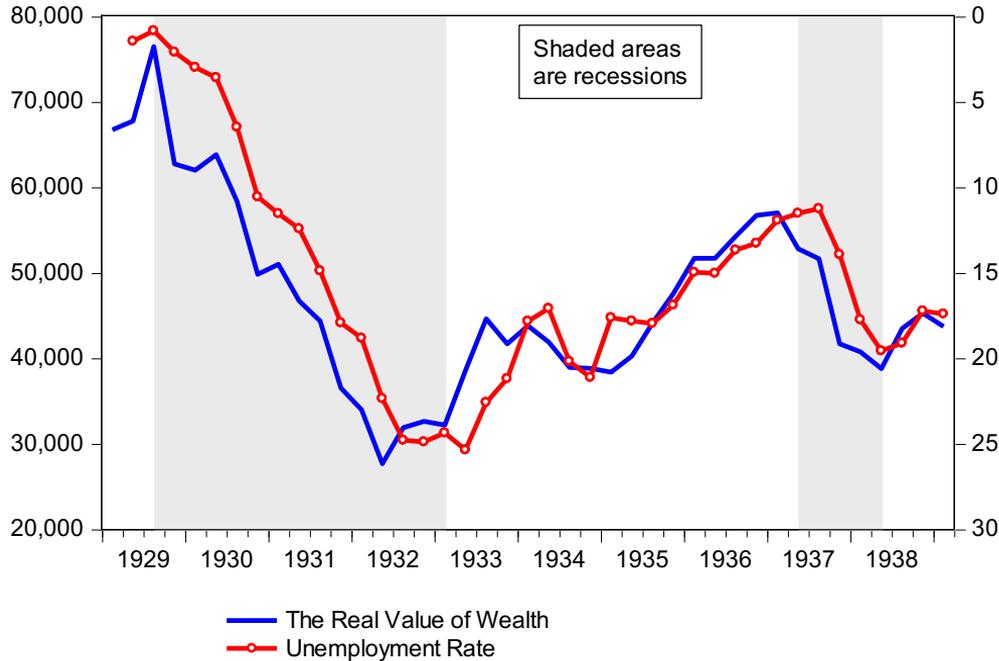
1. DSGE models are deeply flawed
2. Insights from the 'information revolution' have been ignored particularly with regard to financial markets
3. John provides some insights from his own work on forecasting inflation and business cycles

Three Themes of my Discussion

- How should we incorporate information theory?
- Not just amplification! Continuum of steady state unemployment rates! i.e. hysteresis!
- Forecasting: Is hysteresis due to demand or supply?

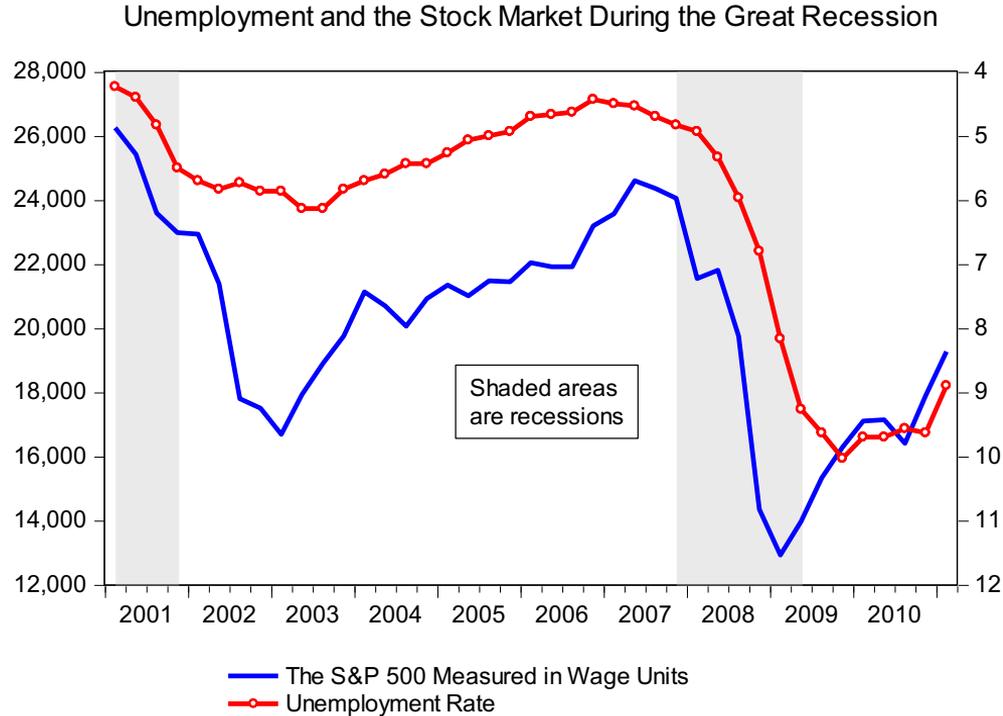
The Great Depression

Unemployment and Wealth During the Great Depression



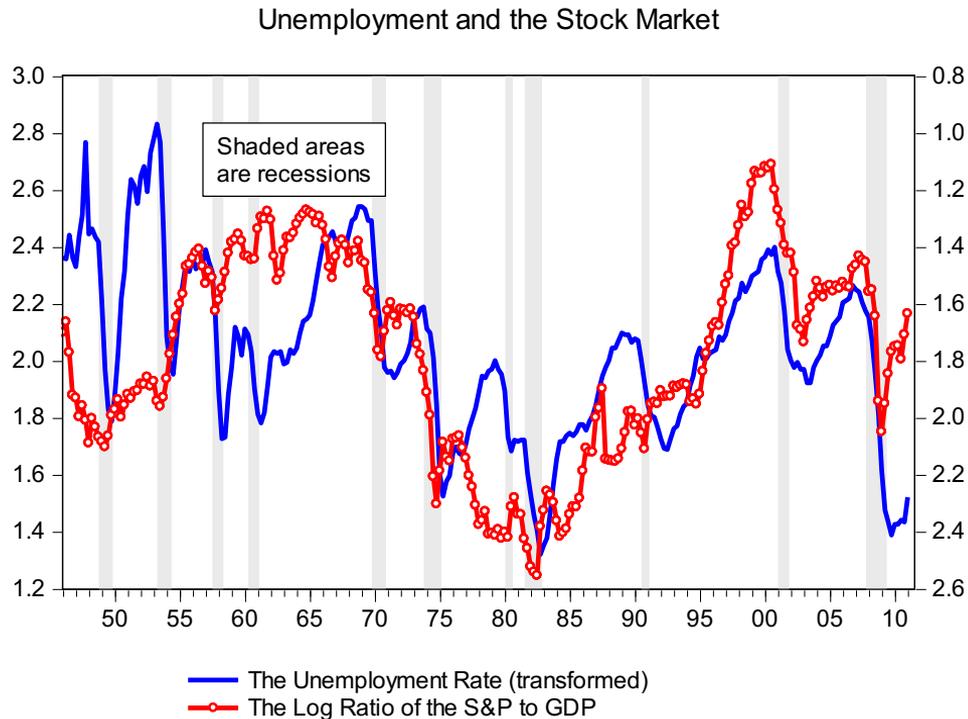
The financial markets mattered in 1929!

The Great Recession



The financial markets mattered in 2008!

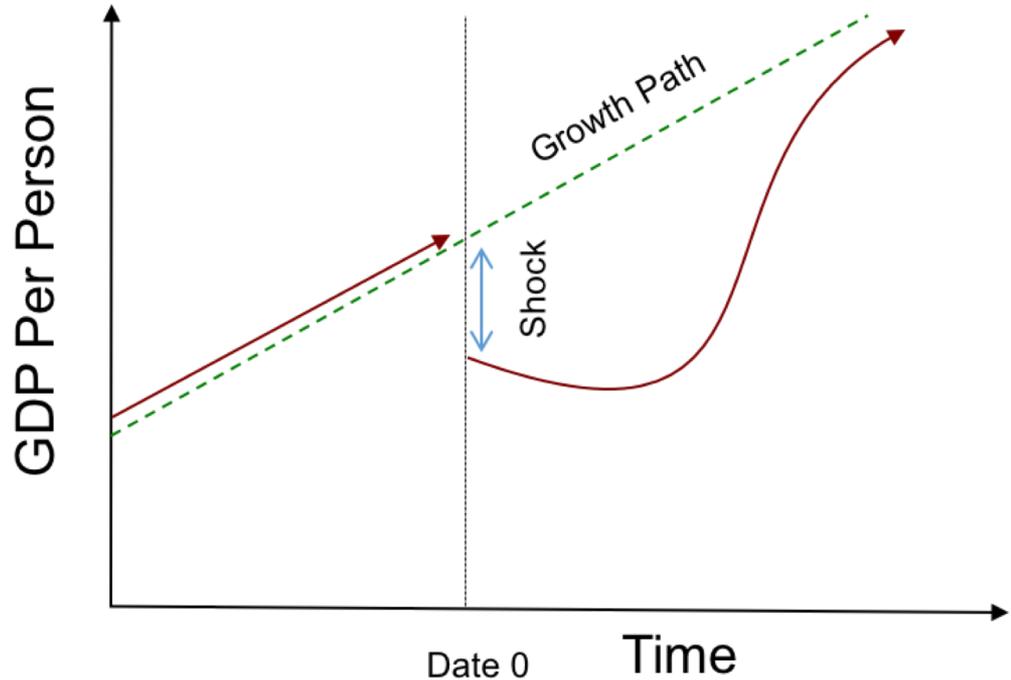
Post-War Unemployment and the Stock Market



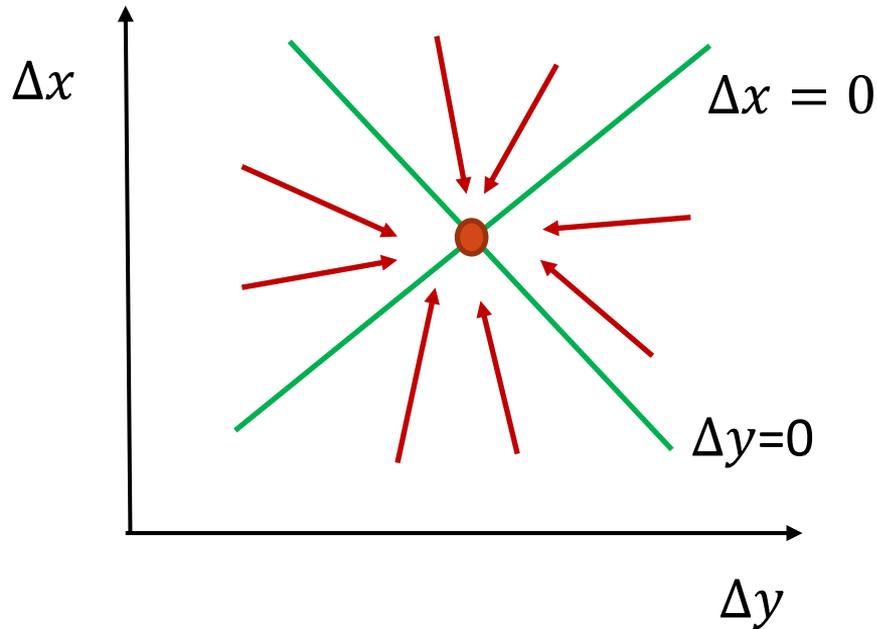
Unemployment and the stock market are non-stationary and co-integrated

Wicksell's Rocking Horse Model

- This picture shows how the New-Keynesian model responds to a shock
- It is an example of a **rocking-horse model**



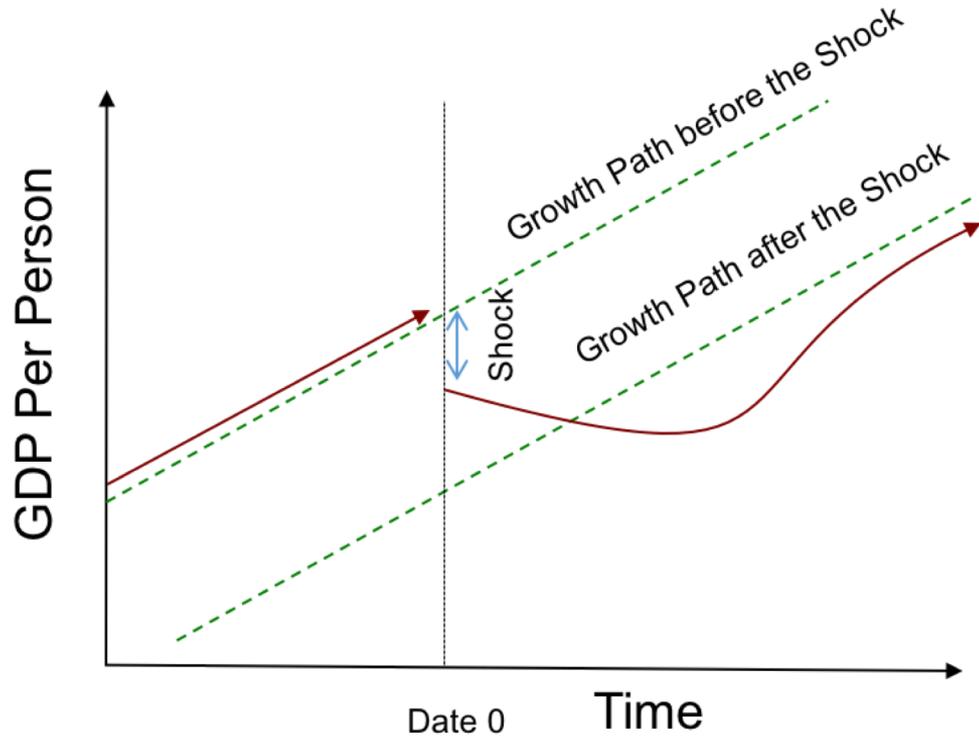
A VAR converges to a point



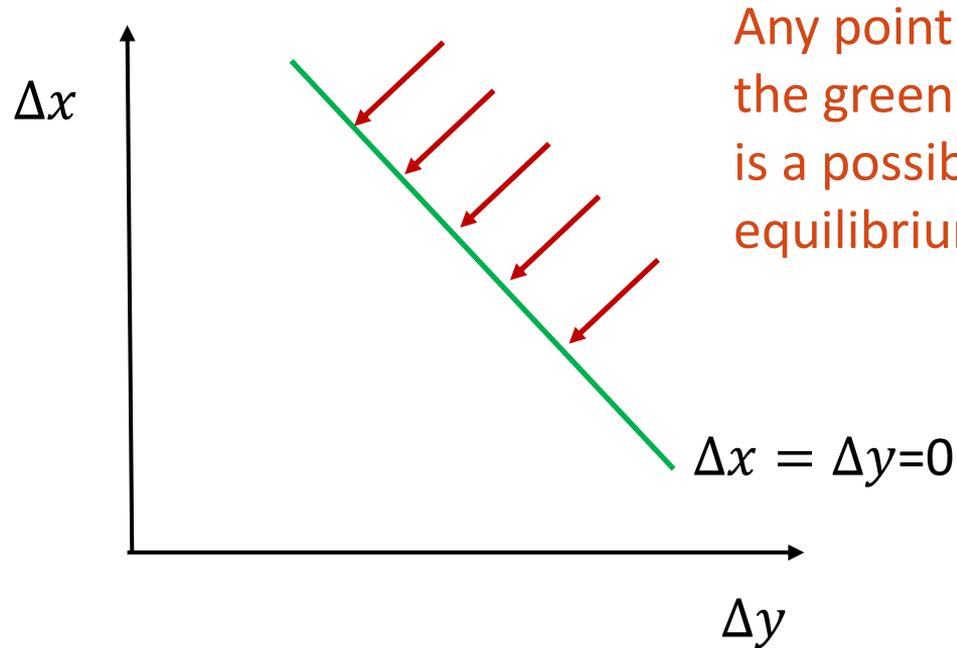
Conventional models are represented by VARs

The Windy Boat Model

- This picture shows how model with hysteresis responds to a shock
- It is an example of a **windy-boat model**



A VECM converges to a set

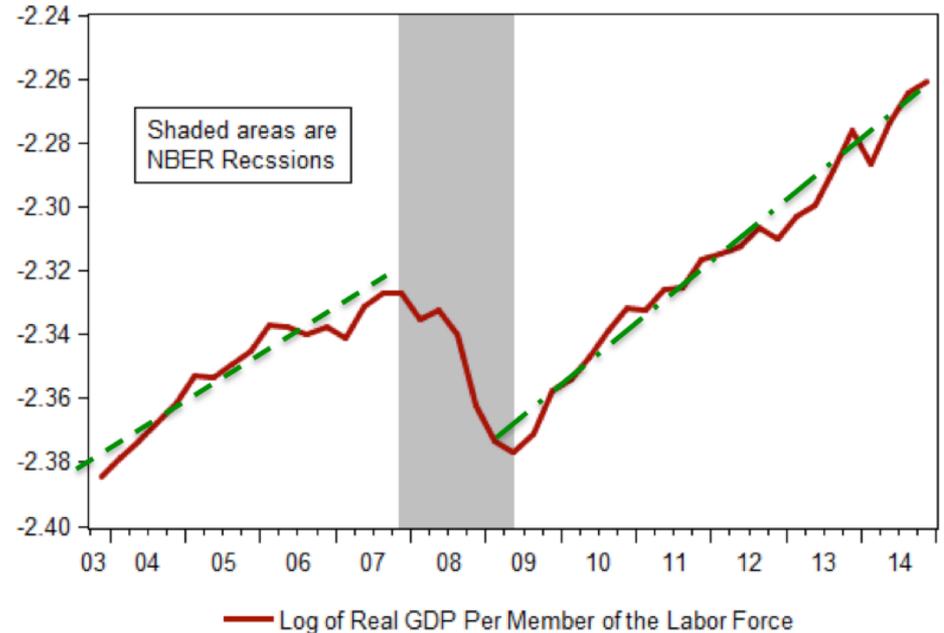


Any point on the green line is a possible equilibrium

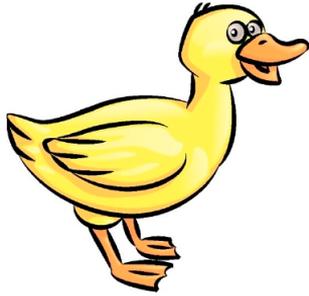
We need models represented by VECM's where unemployment may be non-stationary

This is What Happened in the Data

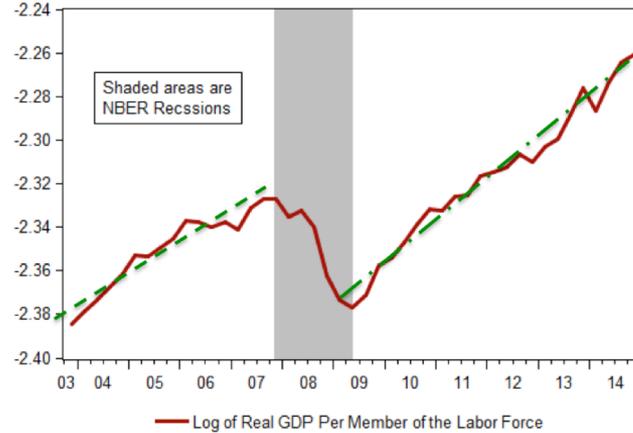
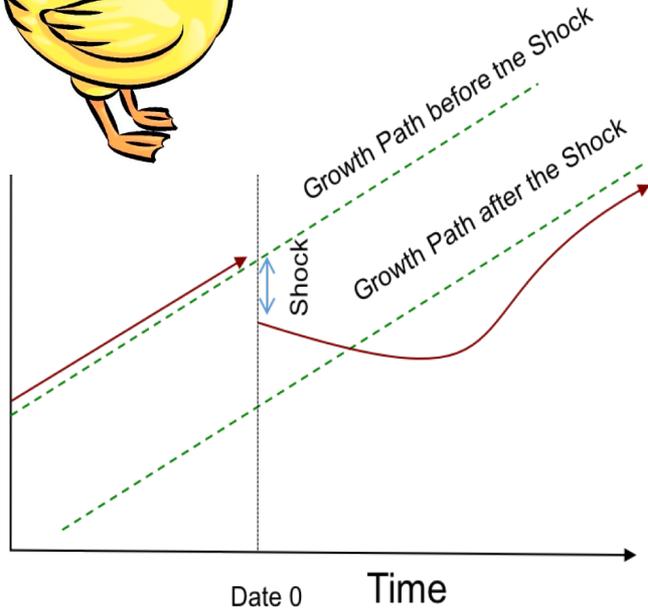
- GDP per person still has not returned to trend eight years later after the collapse of Lehmann Brothers



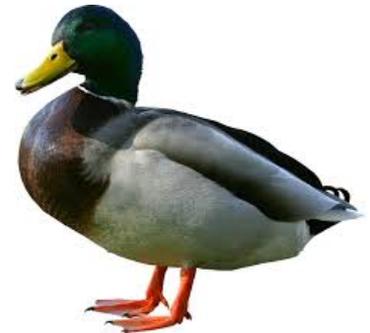
If it Looks Like Duck....



GDP Per Person



...swims like a
duck and quacks
like a duck...



Conclusion

- Yes DSGE models are flawed:
- Yes we can learn from the information revolution but tweaks and frictions are not enough
- Key question for policy makers: Can we affect the long-run unemployment rate through monetary and fiscal policy?

Thank You for Listening

