The Future of Macroeconomics

A Discussion of a paper by John Muellbauer
Prepared for the ECB Colloquium in Honour of Vítor Constâncio
By
Roger E. A. Farmer
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!

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The Great Recession

Unemployment and the Stock Market During the Great Recession

The financial markets mattered in 2008!

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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....

...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

Hmm... Perhaps I need to buy his book