EC2B3 Macroeconomics II

Winter Term 2025

Course description

This an intermediate-level course in macroeconomics that builds on the material you covered in EC1B3 Macroeconomics I. You will learn about money and inflation, and how central banks can use monetary policy to control inflation. You will study business cycles – booms and recessions – and the potential role for fiscal and monetary policy in stabilizing the economy. You will learn about the interaction between the economy and financial markets and banks, especially in times of crisis. You will also study the international aspects of macroeconomics arising from trade in goods and financial assets with the rest of the world. We will apply the tools developed in the course to historical and contemporary events.

Lecturer

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Teaching

There are lectures in the Peacock Theatre on Tuesdays 13:00-14:00 and Wednesdays 11:00-12:00 in weeks 1-5 and weeks 7-11 of Winter Term. Lectures are recorded and recordings will be available a few hours after each lecture.

Classes run in weeks 2-5 and weeks 7-11 of Winter Term, and additionally in week 1 of Spring term.

Note that there are no lectures or classes in week 6 (Reading week).

Formative assessment

There are problem sets for each of the weekly classes and students should attempt these in advance of classes. Two of the problem sets will be marked and feedback provided.

Reading

There is no set textbook for the course, though for some topics, Williamson, *Macroeconomics*, 6th ed. (2018) may be used. Lecture material may be complemented by supplementary readings available on the course's Moodle page. Recommended readings are marked with (*).

Support

Online Q&A sessions: These will be held on Thursdays 14:00-15:00 in weeks 2, 4, 7, 9, and 11. A Zoom link will be posted on the Moodle page.

Lecturer's office hours: Mondays 09:30-10:30 and 14:30-15:30 in room SAL.1.09. Meeting slots can be booked via Student Hub.

Support Lab: Class teachers and the course manager will hold office hours starting from week 3, held in LSE Life. A schedule will be posted on the course's Moodle page. You may attend any class teacher's office hours.

Discussion Forum: Please post any questions on the course material to the Ed discussion forum rather than by email to the lecturer or class teachers. A link to the discussion forum can be accessed via the course's Moodle page.

Assessment

The course is assessed by a 2-hour exam in the summer exam period. This exam constitutes 90% of the overall mark for the course. 10% of the overall mark comes from continuous-assessment coursework in Winter Term.

Continuous assessment: **You are required to submit 8 problem sets (each contributing 0.5% to the course mark, a total of 4% out of the 10% for continuous assessment). The deadline for submitting your attempt is Monday 9am in the week the class takes place** (this will ensure everyone has the same amount of time to work on the questions before classes begin). Marks will be awarded in full for engaging with the problem set, not for getting things right – however, your submission needs to be a meaningful attempt for you to get the mark. That means you have to try the problem set questions – you can get things wrong, and by all means flag up where things are confusing to you so your teacher can explain those bits in class, but your submission should show evidence of having given it a shot. While each student should submit their attempt individually, you are free to work with fellow students on the problem sets, except where the work is formally marked.

Problem sets 4 and 9 will be marked and feedback provided (each contributing 3% to the course mark, a total of 6% out of the 10% for continuous assessment). So, two of your eight submissions will be these specific problem sets. This work must be done individually. Your mark will count here, e.g., if you get 70% on both problem sets you will get 0.7(6) = 4.2 out of the 10% for these contributions.

Course contents

1: Money and central banks

Contents: characteristics of money, the banking system, central banks and the instruments of monetary policy, controlling interest rates

Questions to address:

- How do central banks interact with financial markets and the banking system?
- How should monetary policy be conducted? What changed since the 2007-8 financial crisis?
- How do cryptocurrencies and central-bank digital currency (CBDC) differ from long-established forms of money?

2: Banks and financial intermediation

Contents: banking and maturity transformation, the Diamond-Dybvig model, bank runs, bank regulation

Questions to address:

- What is the role of banks and why are they inherently fragile?
- How should the banking system be regulated?
- Would the monetary system work better if commercial banks were prevented from creating money by imposing 100% reserve requirements?

3: Business cycles

Contents: measurement of cyclical fluctuations in macroeconomic variables, review of key ideas from introductory macroeconomics, a macroeconomic model with flexible prices, supply shocks

Questions to address:

- Why does economic activity fluctuate over time?
- What are the shocks that cause booms and recessions?
- How does the economy respond to supply shocks such as rising energy costs?

4: Nominal rigidity

Contents: imperfectly competitive markets and sticky prices, the Fisher equation, the natural rate of interest, demand shocks, stabilization policy

Questions to address:

- Can and should policymakers seek to ameliorate business cycles?
- What is the 'natural rate of interest' and what role does it play in policymaking?

5: Inflation and the Phillips curve

Contents: the Phillips curve, inflation expectations, the Lucas critique, Taylor rules for monetary policy

Questions to address:

- What is 'stagflation' and how did it occur in the 1970s?
- Why is the Phillips curve relationship not stable over time?
- What do central banks need to do with interest rates to get inflation under control?

6: Aggregate demand and monetary and fiscal policy

Contents: inflation targeting, time inconsistency, gains from commitment over discretion in policymaking crowding out and multiplier effects, credit frictions and collateral constraints

Questions to address:

- Should central banks prioritize controlling inflation or focus on boosting real GDP?
- Can a fiscal stimulus raise GDP by more than the extra government spending?
- Why do asset prices affect the economy?

7: Unconventional monetary policy at the interest-rate lower bound

Contents: the yield curve, the expectations theory of long-term interest rates, forward guidance, risk and portfolio choice, quantitative easing

Questions to address:

- Should we worry about an 'inverted' yield curve?
- What is forward guidance, and how effective is it as a monetary policy tool?
- Is quantitative easing different from printing money?

8: Money and exchange rates

Contents: the demand for money, interactions between fiscal and monetary policy, the lower bound on nominal interest rates, the liquidity trap, purchasing power parity, exchange-rate regimes

Questions to address:

- Why has the link between money supply growth and inflation been unstable?
- Is it better to have a monetary system without physical cash?
- How are negative interest rates possible, and are they ever desirable?

9: International trade in goods and assets

Contents: gains from international trade, the balance of payments and the current account, capital flows, sovereign debt

Questions to address:

- What are the causes of 'global imbalances'?
- Do government budget deficits cause current-account deficits?
- What triggers sovereign-debt crises?

10: International macroeconomics

Contents: uncovered interest parity, capital mobility and capital controls, the trilemma

Questions to address:

- Are monetary and fiscal policy effective in an open economy where capital can flow freely?
- What are the macroeconomic effects of tariffs?
- Should exchange rates be fixed or left to float?
- What are the causes of currency crises and the collapse of fixed exchange-rate systems?