Debt Covenants, Investment, and Monetary Policy by Ozgen Ozturk

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Summary

$$\left.\begin{array}{l}\bullet\ \text{Real Businesses Cycles}\\[2em] \bullet\ \text{New Keynesian models}\end{array}\right\}\ \text{DSGE models}$$

- Dynamic Stochastic General Equilibrium
- RBC & NK (plain vanilla) models assume perfect financial markets
  → DSGE models with financial frictions go a step further

Summary

- DSGE models are micro-founded

- They make assumptions regarding:
  (1) Preferences (log utility, CRRA, GHH...)
  (2) Technology (Cobb Douglas PF, CES...)
  (3) Market structure (Complete-incomplete markets, heterogeneity, FF...)

Background Literature

- Seminal RBC models: Kydland and Prescott (1982) & Long Jr and Plosser (1983)

- New Keynesian bible(s):
  - Gali (2015) *Monetary Policy, Inflation, and the Business Cycle: An Introduction to the New Keynesian framework and Its Applications, Second Edition.* Princeton University Press
  - Woodford (2011) *Interest and Prices. Foundations of a Theory of Monetary Policy.* Princeton University Press

- General DSGE
  - Miao (2020) *Economic Dynamics in Discrete Time.* MIT press

- State of the art multi-shock and frictions NK-DSGE model: Smets and Wouters (2007)

RBC to NK to FF DSGE

- RBC: Neoclassical model where agents optimize with rational expectations
- New Keynesian environment adds price and/ or wage stickiness
- Financial frictions eliminate complete markets
    - Sometimes these frictions are very specific, derived from microfounded behavior, while sometimes they are more ad-hoc (reduced form)

References I

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Kydland, Finn E and Edward C Prescott (1982). "Time to build and aggregate fluctuations". In: *Econometrica*, pp. 1345–1370.

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