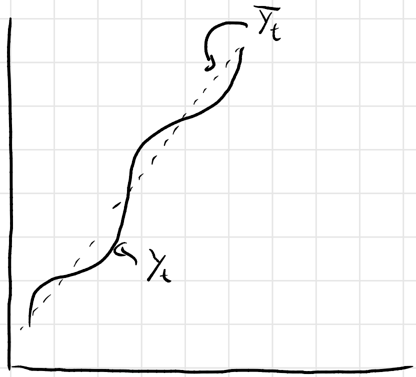
March 8: The short run

1) what causes business cycles?

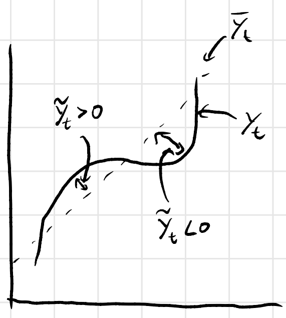
2) What policy tools can we use to counteract business cycles?



Output gap $= \dfrac{Y_t - \bar{Y}_t}{\bar{Y}_t} = \tilde{Y}_t$

$\tilde{Y}_t > 0$: positive output gap

$\tilde{Y}_t < 0$: negative output gap



Output gap is key outcome variable in short run

Most recessions last about 2 years:

- lose about 6% GDP per capita

- unemployment usually rises 2%
  - but Great recession was much more severe

Key features of SR model:

- shocks cause business cycles
  - COVID Recession: pandemic
  - Great Recession: housing bubble burst
  - 2001 Recession: Dot-com + 9/11
  - Volcker Disinflation: spiking interest rates
  - Great depression: the gold standard, unit banking, stock market crash

Monetary and Fiscal policy:

- Monetary policy: central bank changes money supply and interest rates

- Fiscal policy: govt. spending and taxation policy