

Foundations of Macroeconomics

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Católica-Lisbon

2025-2026

INTRODUCTION: WHAT IS MACROECONOMICS?

- Macroeconomics studies the economy as a whole:
 - the interaction of many people and firms
 - through markets
 - determining aggregate outcomes such as production, income, and prices
- Microeconomics, in contrast, focuses on individual people, firms, or markets
- Despite this distinction, macroeconomics and microeconomics are deeply connected:
 - aggregate outcomes emerge from individual decisions
 - understanding the macroeconomy requires understanding microeconomic behavior

INTRODUCTION: BIG QUESTIONS IN MACROECONOMICS

- One way to understand macroeconomics is through the questions it asks:
 - Why are some countries so much richer than others?
 - Why is the average Portuguese today many times richer than a century ago?
 - How does Portugal compare to other countries, such as Germany or Ethiopia, in terms of average income?
 - Why do economies experience booms and recessions?
 - How do we understand Portugal's recessions during the European debt crisis?
 - What causes declines in employment and output?
 - What determines inflation?
 - Why do some countries experience hyperinflation, where prices can explode and render the currency nearly worthless?

HOW ECONOMISTS STUDY THE ECONOMY

- Economists use models to understand how the economy works.
 - Models are simplified representations of reality.
 - They help us isolate the key mechanisms behind complex economic phenomena.
 - By focusing on essential relationships, models allow us to make predictions and analyze policy effects.
- Why use models in macroeconomics?
 - The economy is very complex; we cannot study every detail at once.
 - Models provide a consistent framework to think about interactions between households, firms, and markets.
 - Without models, explanations would be descriptive or ad hoc, could be inconsistent and it would be hard to compare policies or predict outcomes.

IN A NUTSHELL

- The course provides an overview of core topics in macroeconomics:

① GDP and Living Standards

We study one of the main variables macroeconomists care about: GDP. How it is measured, its shortcomings, and how economic theory can guide better measurement.

② Production

We analyze our first general equilibrium model. We explain what general equilibrium means and how a simple production model helps us think about why some countries are poorer than others: productivity differences versus capital accumulation. We also discuss how production functions help us think about whether AI will replace jobs.

③ Growth

We review key facts about economic growth and study the Solow growth model: why growth occurs and how it is sustained. We confront the model with the data.

IN A NUTSHELL (CONT.)

- The course provides an overview of core topics in macroeconomics:

④ Labor-Leisure

We analyze what drives decisions about how much to work, depending on wages and taxation. Why do Americans work more than Europeans?

⑤ Consumption–Savings

We analyze how individuals choose consumption and savings over time, and how these decisions respond to income, interest rates, and uncertainty.

⑥ Money (and Inflation)

We study the role of money in the economy: what it is, how its quantity is determined, and why people hold it. We analyze equilibrium in the money market, the price level, and inflation.

IN A NUTSHELL (CONT.)

- The course provides an overview of core topics in macroeconomics:

⑦ Money and Banking

Measures of money, the role of banks, bank runs, and how central banks control the money supply.

⑧ Business Cycles

The economy in the short run. How central banks use monetary policy to stabilize output and control inflation.

⑨ International Finance

Exchange rates, the law of one price, and monetary policy in an open economy.

ORGANIZATION

- Three main references:
 - Chad Jones, *Macroeconomics*
 - Pablo Kurlat, *A Course on Modern Macroeconomics*
 - Jon Steinsson, online lecture notes
- In each chapter, we will study both theory and data
- There will be problem sets for each section
- You may work in groups, but each student must submit an individual assignment

GRADING

- Quizzes + Problem sets: 25%
- Midterm + Final Exam: 75%