

## **BIOAGRAPHY**

**Jordi Galí** earned his PhD in Economics at Massachusetts Institute of Technology in 1989. He is Director and Senior Researcher of the Center for Research in International Economics (CREI), and Professor at Universitat Pompeu Fabra, Economics Department.

Galí's research centers on the causes of business cycles and on optimal monetary policy, especially through the lens of time series analysis. His studies with Richard Clarida and Mark Gertler suggest that monetary policy in many countries today resembles the Taylor rule whereas the policy makers of the 1970s failed to follow the Taylor rule.

Another theme of Galí's research is how central banks should set interest rates. In some of the simplest New Keynesian macroeconomic models, stabilizing the inflation rate stabilizes the output gap too. If this property were roughly true in reality, it would permit central bankers to pursue a simplified Taylor rule focused only on inflation stabilization, with no need to consider output growth. Jordi Galí and Olivier Blanchard have called this property the 'divine coincidence', and have argued that in more realistic models which include additional frictions, it no longer holds. Instead, models with additional frictions (such as frictional unemployment) imply a tradeoff between stabilizing inflation and stabilizing the output gap.

## **PROJECT**

### **European Research Council Advanced Grant**

Project acronym: LABPOL

Project full title: Labor markets, economic fluctuations, and monetary policy.

### **Overview**

The New Keynesian (NK) model has emerged in recent years as the workhorse for monetary policy analysis. The first part of the proposed project is motivated by two shortcomings of that framework: (i) the lack of an explicit analysis of unemployment and its potential role in the design of policy, (ii) the limited empirical support for the model's wage-setting block. One of the objectives of the proposed project is the assessment of the empirical relevance of the specification of the wage-setting block found in standard versions of the NK model, with a special focus on their implied wage-unemployment dynamics. As part of my project, I will show how the standard NK model with staggered wage setting implies a relationship between wage inflation and unemployment that fails to capture important features of the data. I also plan to develop and study an extension of the NK model that incorporates in a tractable way real wage rigidities (coexisting with nominal rigidities), with the objective of (i) assessing their

relative role in explaining the observed patterns of wages and unemployment, (ii) analyzing their implications for the design of monetary policy. The second part of the project is motivated by the significant changes in the co-movements among some key macro variables that have accompanied the recent period of low macroeconomic volatility (the so-called Great Moderation). One objective of the proposed research is to understand the role that structural change in the labor market may have played as a source of those changes. In particular, I plan to analyze the causes of the vanishing pro-cyclicality of labor productivity and their potential causes, including a more subdued use of labor hoarding by firms, possibly as a result of lower hiring/firing costs. In addition, I plan to study the consequences that such structural changes may have had on wage setting, and their ability to account for the apparent increase in wage flexibility during the recent period.