

Economics 242: Numerical Methods for Macroeconomists*

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January 2016

Grading: Three take-home exams.

Textbook: Greenwood, Jeremy. *Numerical Methods for Macroeconomists*.
New material will be placed online.

(Background–optional): Gilat, Amos. *MATLAB: An Introduction with Ap-
plications*, 5th Edition, 2015.

Programming Language: MATLAB (from Mathworks).

There cannot be a language more universal and more simple,
more free from errors and obscurities,...more worthy to express the
invariable relations of natural things than mathematics. It interprets
all phenomena by the same language, as if to attest the unity and
simplicity of the plan of the universe, and to make still more evi-
dent that unchangeable order which presides over all natural causes.
Joseph Fourier, *Analytical Theory of Heat*, 1822

Many people have a passionate hatred of abstraction, chiefly, I
think because of its intellectual difficulty; but as they do not wish
to give this reason they invent all sorts of others that sound grand.
They say that all reality is concrete, and that in making abstractions
we are leaving out the essential. They say that all abstraction is
falsification, and that as soon as you have left out any aspect of
something actual you have exposed yourself to the risk of fallacy in
arguing from its remaining aspects alone. Those who argue in this
way are in fact concerned with matters quite other than those that
concern science. Bertrand Russell, *The Scientific Outlook*, 1931.

1 Description

This course will study some of the numerical methods that are used in modern
macroeconomics. The class will learn how to solve dynamic programming prob-
lems, nonlinear equations, difference equations, interpolate functions, smooth

*Reading list may be subjected to change.

data, and conduct Monte Carlo simulations on the computer. This will be done while studying economic problems, such as the determination of labor supply, economic growth and business cycle analysis. Calculus is an *integral* part of the course and some elementary probability theory will be drawn upon. The MATLAB programming language will be used.

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Departmental policies regarding courses are available here:
<http://www.econ.upenn.edu/undergraduate/policies>

2 Grading

The course will be evaluated on the basis of three take-home exams. The third take-home exam will be handed out on Monday April 25th and is due by midnight Sunday May 1st. *No* collaboration with *any* person (either in or out of the class) is allowed for the exams. You are also not allowed to use programs from the web. The exams will be graded on a mixture of the skills you show in economics, mathematics and programming. More than enough time is given for each exam. A 10% penalty is assessed for each day an exam is late.

3 Nonlinear Equations

3.1 Application, Labor-leisure choice

- Jeremy Greenwood and Guillaume Vandenbroucke (2008). “Hours Worked (Long-Run Trends).” *The New Palgrave Dictionary of Economics*, v. 4, 2nd edition, edited by Lawrence E. Blume and Steven N. Durlauf (New York, N.Y.: Palgrave Macmillan), 75-81.
- Edward C Prescott (2004). “Why Do Americans Work So Much More Than Europeans?” *Federal Reserve Bank of Minneapolis Quarterly Review*, Vol. 28, No. 1: 2–13.

3.2 Methods

- Bisection Method
- Newtons Method

4 Deterministic Dynamics

4.1 Application, the neoclassical growth model

- Gary D. Hansen and Edward C. Prescott, “Malthus to Solow,” *American Economic Review*, 92 (September 2002): 1205-17.

4.2 Methods

- Extended Path Method
- Multiple Shooting

5 Stochastic Dynamics

5.1 Application, business cycles

- Edward C. Prescott (1986). “Theory ahead of business cycle measurement.” *Federal Reserve Bank of Minneapolis Quarterly Review*, 9-22.
- Jeremy Greenwood, Zvi Hercowitz and Gregory W. Huffman (1988). “Investment, Capacity Utilization, and the Real Business Cycle,” *American Economic Review* v. 78: 402-417.

5.2 Methods

- Cubic Smoothing Splines
- Linearization Techniques
- Numerical Differentiation
- Monte Carlo Simulation
 - Random Number Generation
- Dynamic Programming
 - Discrete State Space Dynamic Programming
 - Markov Chains