

Econ 308 - Money and Banking

Instructor: Richard Walker

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1 Contact details

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Office hours: Tuesdays 9-10.30am in KGH 3493 (i.e. 'New Kellogg', 3rd floor). I'll have office hours for another class from 10.30am-noon on Tuesdays; you can turn up and take your chances then too. Otherwise get in touch.

We will meet twice a week, on Mondays and Wednesdays at 9.30am in Tech LR4.

The TA will announce his/her office hours separately. Discussion sections will be on Fridays at 9.30am in Harris Tech LR4.

2 Evaluation

- Two assignments, due on Monday April 22nd and Wednesday May 22nd. (20% each)
- Midterm on Monday April 29th. (30%)
- Final exam at 9.30am on Friday May 31st. (30%)

NOTE: the final is on the last day of class. Also, while the final will focus on the second half of the course, it may require students to draw on their knowledge of the earlier material.

3 Course Overview

This is a course in monetary economics. The aim is to convey the fundamentals of monetary theory and policy, and to examine select topics in finance and in monetary history. It is not a course in 'pure' finance and not designed to prepare you for a career in investment banking. You will not learn how to price esoteric options or read banks' balance sheets, although asset pricing and balance sheets will both turn up somewhere. You will instead learn something about economists think about 'money' more generally, in particular regarding the problems faced by monetary policymakers. The course does not consist entirely of analysis of the recent financial crisis, but does culminate in a week or two of this sort of thing.

Prerequisites for the course are 201, 202, 281, 310-1, 311, Math 220, Stat 210. Students should already be comfortable with basic differential calculus; I might show you some integrals at some point, but you will not have to actually perform any integration. You should also be familiar with the standard IS/LM macroeconomics framework. We'll review the IS/LM model near the start of the course, but will go over it fairly quickly.

Previous iterations of this course 'used' two textbooks: Frederic Mishkin's *The Economics of Money, Banking and Financial Markets* [8th edition], hereafter **FM**; and *Money, Banking, and Financial Markets* [1st edition] by Laurence Ball (**LB**). Each covers a wide range of topics at an intermediate level, and as such is not pitched at the ideal level for this course. We will cover fewer topics than either book and will sometimes go a little deeper into theoretical issues than they do. We will also cover some topics that they ignore completely. While the books make for good preparatory and background reading, and will be sufficient for some areas, the slides I present in class will constitute the main resource for students. You should consider **FM** and **LB** as optional, as it's perfectly possible to do the course without buying either one of them. For what it's worth **FM** is relatively the stronger for the first half of the course, **LB** for the second.

In addition to the posted slides I will provide supplementary readings where appropriate, and occasional notes when no suitable source is available.

4 Lecture topics and references

The plan is to tackle the following subjects in order. If it looks like we're falling behind, certain sections will be abbreviated. I will keep students informed of potential adjustments to the syllabus as soon as they look likely. Textbook readings are obviously only relevant if you choose to buy a textbook. Other readings are mandatory save those marked with an asterisk, which are optional.

4.1 Introduction/revision/basic concepts

Review of basic concepts, and a roadmap for the rest of the course.

- functions and definitions of money
- the quantity equation and money neutrality
- short-run non-neutrality in the IS/LM framework

Readings: **FM** Ch. 3, Ch. 19 (pp.493-500), Chs 20-22; **LB** Ch. 2 (pp.25-36), Ch. 14 (pp.413-417) [note that **LB** has nothing on IS/LM, which is perhaps in its favour].

4.2 Hyperinflations and fiscal credibility

The importance of fiscal rectitude in underpinning the value of the medium of exchange.

- the Cagan model of hyperinflation
- the ends of big inflations: the role of fiscal policy

Readings: <http://gregmankiw.blogspot.com/2006/04/time-inconsistency.html>
*“The Realities of Modern Hyperinflation”, Reinhart & Savastano (Blackboard).

4.3 Money demand: theory and evidence

Examination of the main theories of money demand.

- transactions demand and the Baumol-Tobin model
- portfolio demand: money as an asset
- empirical evidence

Readings: My supplementary notes.

4.4 Monetary policy instruments

Consideration of the policy tools available to central banks.

- institutional arrangements in the US
- central bank control of the money supply
- choice of monetary target: quantity or price?

Readings: FM Ch. 12 (pp.311-322), Ch. 13, Ch. 14 (not the appendix), Ch. 15; LB Ch. 11.

4.5 The term structure of interest rates

What can the bond market tell us about expected Fed policy?

- bond pricing
- no-arbitrage and the yield curve

Readings: LB Ch. 4 (pp.102-109), Ch. 13 (pp.383-390).

4.6 The monetary transmission mechanism

How does money affect aggregate demand?

- evidence on the traditional 'interest rate' channel
- information asymmetries, lending and the importance of net worth
- the credit channel

Readings: FM Ch. 8 (pp.181-192, 195-198), Ch. 23 (pp.596-609); LB Ch. 11, Ch. 13 (pp.390-399);
"Credit Channel Effects in the Monetary Transmission Mechanism", Bank of England (Blackboard);
*"Inside the Black Box: The Credit Channel of Monetary Policy Transmission", Bernanke & Gertler (Blackboard).

4.7 Modern policymaking

Discussion of the appropriate objectives for policymakers.

- the 3-equation framework
- time inconsistency and solutions
- inflation persistence and structural uncertainty

Readings: FM Ch. 16 (omit the section on Monetary Targeting; skim the rest); LB Ch. 12 (pp.352-377), Ch. 15, Ch. 16; supplementary notes;
<http://gregmankiw.blogspot.com/2006/04/time-inconsistency.html> again

4.8 The credit crunch

Examination of the current financial crisis.

- what just happened?
- unconventional monetary policy

Readings: LB Ch. 14 (pp.433-438), Ch. 18 (pp.543-651); other readings to be provided;
*“Monetary Policy Alternatives at the Zero Bound: An Empirical Assessment”, Bernanke, Reinhart & Sack (Blackboard).

5 Comments, policies

- The midterm and final dates/times are not negotiable. There will be no early finals to accommodate family holidays, unfortunately-timed job interviews, etc.
- Similarly for assignments. There are only two, and they must be handed in on time. Failure to do so, especially (but not only) with no prior warning, will result in points deducted.
- If you think you were unfairly denied marks on an assignment or exam, do the following. First, recheck the answers (which might not be published, but if not which will be covered in a section or class). If you still think it's unfair then take the matter up with your TA to see if s/he agrees. If you still think it's unfair then (and only then) bring it to me; I will remark the entire assignment/exam, and reserve the right to deduct points as well as add them.
- Will I be grading on a curve? It depends what you mean by 'curve'. In general, I do not have any preconceived idea of some particular grade distribution I want to see.
- Further to the grading: don't panic if you see you got a 70 on a test and think you failed. Check the letter-grade/number-grade correspondence.
- I expect that students will work together when solving the assignments. I may even allocate you to groups. However, I require you to write up the answers separately.

- If you don't understand something as we're going through it, that's fine. Just be sure to see me or the TA quickly to sort things out.
- There are questions for discussion in each Friday section. It is a very good idea if you look at these beforehand and try to answer them.
- There will be no *ex post* reweighting of the relative contributions of assignments and exams to the final grade. Please don't ask, as I find saying 'no' painful, albeit not painful enough never to say it.
- However, I do bear everything in mind when assigning final letter grades. If someone ends up being extremely close to the next grade up, **and** has shown remarkable improvement over the course of the quarter, then it's possible I'll give them the higher grade. Note that this is entirely at my discretion, and that lobbying is counterproductive.
- Please ask questions in class if something is not clear.