Syllabus for Econ 308 - Money & Banking

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We will meet twice a week: Mondays and Wednesdays from 11am-12.20pm in University Hall 102. Sections will be on Fridays at the same time and place.

Office hour details (mine and those of the TA, Sergio) will be posted on Canvas. My office is KGH 3493 (i.e. Kellogg Building, 3rd floor).

Classroom technology policies:

- All the classes will be in person, and I do not intend to record any of them.
- To maintain a focused learning environment, **no cellphones or laptops allowed**. Put them away please. If you have a documented disability requiring the use of a laptop, get in touch.
- You may use a tablet in class just for taking notes, but you must keep it flat on your desk so as not to distract your peers.

1 Course overview

This is a course in monetary economics. The aim is to convey the fundamental 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 2007-8 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 do so quickly.

1.1 Evaluation

Evaluation will be based on three exams:

- Midterm 1 in section on Friday April 24$^{\text{th}}$ (33.33%)
- Midterm 2 in section on Friday May 15$^{\text{th}}$ (33.33%)
- Midterm 3 in section on Friday May 29$^{\text{th}}$ (33.34%)

The exam dates/times are not negotiable. If you cannot make these exams then you cannot take the class.

1.2 Sections

Section attendance (outside exam weeks) is not mandatory but will be useful. Each week I will post supplementary questions on Canvas. The TA will go through some or all of these questions in sections; I strongly recommend that you consider them beforehand. You will get a lot more from the course, and find the exams much easier, if you attend sections.

2 Course materials

There will be slides for each topic posted on Canvas. These will be covered in lectures. There will be three versions of the slides available: one identical to that I use in lectures; one in 'handout' form that omits the dynamic overlays but otherwise resembles the version I go through; and one in 'article' form that's even more compact. These slides will constitute the core material for this course. The exams will be based on their contents and on the supplementary questions I post.

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

As for a textbook, below I list readings from two books: 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. My sense is that most people do not buy a textbook and do not regret this decision.

3 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.

3.1 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].

3.2 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

3.3 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.

3.4 Monetary policy instruments

Consideration of the policy tools traditionally used by 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.

3.5 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).

3.6 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).

3.7 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

3.8 The credit crunch

Examination of financial crises and consequent policy responses.

- what happened in 2007/8?
- unconventional monetary policy

Readings: **LB** Ch. 14 (pp.433-438), Ch. 18 (pp.543-651); other readings to be provided.

4 Northwestern University Syllabus Standards

This course follows the Northwestern University Syllabus Standards (link). Students are responsible for familiarizing themselves with this information.