Division of Economic and Financial Studies

Macquarie University

Postgraduate Unit of Study Outline

Department of Economics

ECON844
Monetary and Financial Policies

Semester 1, 2008

Mondays 6-9pm

(starting March 3)

Unit of Study Outline

This unit examines a number of issues concerning monetary theory and policy. We begin with an analysis of empirical regularities of money, output, prices and interest rates, with particular reference to Australia. This will lead to the development of the key models of monetary economies in use today. These are invariably based on what is known as "dynamic stochastic general equilibrium models". These models were first developed in the context of real business cycle models with flexible prices. The policy relevant ones include a variety of nominal rigidities, and they are often referred to as "New Keynesian" models. The workhorse version has 3 equations (dynamic IS relation, a modern Phillips curve, and an interest rate rule), which has the virtue that it can be easily manipulated both analytically and numerically. We will examine monetary and fiscal policies interactions. Fiscal policy can impose significant intertemporal restrictions on the outcomes for monetary policy. A key issue is how to determine optimal monetary policy, and we will examine how one thinks about this. We will study how monetary policy is implemented, in particular the question of inflation targeting, and we will look at how one might measure the behaviour of the RBA.

1. Teaching Staff

Unit of Study Coordinator:

Name	Professor Jeffrey Sheen
Building and Room	E4B 430
Phone number	9850 7287
Email	jsheen@efs.mq.edu.au
Consultation hours	Wednesday 2-4pm

2. Unit of Study Aims

This elective unit in the postgraduate programs in the Division of Economic and Financial Studies, ECON844, will help provide you with the necessary tools to analyze current issues in monetary theory and policy.

3. Unit of Study Learning Goals

An understanding of the macroeconomic implications of monetary policy is essential for effective managerial decision-making. Making informed decisions about business activity, whether by a consumer or a firm, requires an understanding of the interactions between the key economic variables in the national and international economies.

In this subject, the intention is:

- To understand the what drives the relationships between macroeconomic economic indicators (eg inflation, growth, interest rates, stock market indices) that should be part of every manager's information set;
- To provide a framework for understanding modern dynamic stochastic general equilibrium models; and
- To enable managers to use this understanding to improve decision-making.

4. Assessment

4.1. Types and due dates of assessment

Type	Weighting	Submission date
1. 1 term paper	25%	See 4.2 below
2. Mid-term test	30%	Monday 7 April 6-8pm.
3. End-of-term examination	45%	TBA (Exam period 18 June – 29 June)
Total	**100%**	

4.2. Explanation of assessment

- **One term paper** due at the last lecture of the unit. Details to be provided later

- **One mid-term test** (two hours) on Monday 7 April 2007, 6-8pm in TBA. [If you have a clash with another unit at this time, contact your lecturer.] The mid-semester test will be closed-book. It will involve multiple choice questions, essay questions or small problems based on topics studied in the course.

- **One end-of-term exam** (two hours) in June (time and place to be announced). The end-of-semester exam will be closed-book. It will involve multiple choice questions, essay questions or small problems based on ALL topics studied in the course. Questions will primarily come from the second-half of the course, but not exclusively.

4.3. Academic honesty

Deliberate breaches of academic honesty constitute academic misconduct. These breaches include:
- Plagiarism
- Fabrication of data
- Recycling previously submitted material
- Engaging someone else to complete an assessment on one's behalf
- Misconduct during supervised assessments

The penalties for academic misconduct may include:
- A mark of zero on the assessment
- A fail grade in the unit of study
- Additional assessment (including an unseen exam)
- Reference of the matter to the University Registrar

Issues concerning breaches of academic honesty may be dealt with either through the process of determining academic results in a unit of study, or, in the most serious cases, by invocation of misconduct procedures

4.4. Assessment policy and procedures

4.4.1. Feedback on assessment

The mid-semester test will be discussed briefly in the lecture after it has been returned

4.4.2. Penalties for late assessments

If the essay is not submitted before the expiry time, you will not get marks for it.

4.4.3. Special Consideration and additional assessment

- **Special Consideration**

Special consideration **will** be granted where a student misses an assessment due to illness or misadventure. **Special consideration will not be granted where a student attempts an assessment,** unless the student can demonstrate that their serious illness or misadventure began after the start of the test or exam. If you experience serious illness or misadventure that would impact on your performance, you should miss the assessment and email your lecturer as soon as possible.

4.4.4. Student appeals: Academic and Administrative

A student may appeal against a mark or grade for either a single assessment, or the final assessment for a whole unit of study. Students are encouraged to consult with their unit of study coordinator in the first instance.
A student may appeal against an administrative decision.

5. Classes

Lectures and tutorials: Lectures are at 6pm-9pm on Mondays starting March 3.

Though not compulsory, you should attend every lecture.

Each week, you will be expected to have read the relevant chapters of the text and any additional readings, and to have practised the questions at the end of the relevant chapter of the text. If you have any questions about these, you can post them on Blackboard (on the "Discussion Board").

6. Prescribed Text

Carl E Walsh, *Monetary Theory and Policy* **MIT Press, 2**[nd] **edition, 2003** (hereafter **Walsh**).

7. Response to Student Feedback

The Discussion Board on Blackboard is a useful tool, and should be used.

At the end of the unit, a course evaluation questionnaire will be distributed. Your suggestions will be welcomed. If you have any problems or suggestions during the semester, please contact your lecturer.

8. Communication Policies

8.1. Blackboard and other electronic sites

Lecture outlines along with all handouts, announcements about classes or assessment and other communications will be available on the Faculty's Blackboard site. If you are enrolled properly in the unit through the University, you will be enrolled automatically on the Blackboard site.

You are expected you to check the site regularly. The week's lecture slides will be available on Blackboard on the Sunday evening (if not earlier) before the Monday lecture.

9.1 Consultation and Electronic Contact

Jeffrey Sheen will be available for consultation in E4B 430 on Wednesdays from 2-4pm or by appointment.

9. Topic Guide (preliminary)

Topic 1
   Empirical regularities of money, prices, output and interest rates
Walsh Chapter 1

Topic 2
   Basic monetary models
Walsh Chapters 2 (2.1-2.3) , 3 (3.1-3.3)

Topic 3
   Money and public finance, optimal inflation
Walsh Chapters 4 (4.1-4.4)
McCallum, B.T. & E. Nelson (1999) "An Optimizing IS-LM Specification for Monetary Policy and Business Cycle Analysis" Journal of Money, Credit & Banking, 31, 296-316

Topic 4
   Real business cycle theory, the New Keynesian model with nominal rigidities.
David Romer, Advanced Macroeconomics, McGraw Hill, 3rd edition, 2006 , Chapter 4
Rebelo, S. (2005) "Real Business Cycle Models: Past, Present and Future" Scandinavian Journal of Economics 107 (2), 217–238.
Walsh Chapter 5 (5.1-5.3)

Topic 5
   DSGE models with nominal rigidities
Walsh Chapter 5 (5.4-5.5), Chapter 10 (10.2)
Christiano, L., Eichenbaum, M. & C.Evans (2005) "Nominal Rigidities and the Dynamic Effects of a Shock to Monetary Policy" Journal of Political Economy, vol. 113, no. 1

Topic 6
   Optimal monetary policy
Walsh Chapters 8 (8.1-8.2), 9 (9.1-9.3.1), 11
Clarida, R., J. Gali, and M. Gertler (1999): "The Science of Monetary Policy: A New Keynesian Perspective," Journal of Economic Literature, 37(4), 1661—1707.
Federal Reserve Bank of St Louis Review, March/ April 2005 Vol. 87, No. 2, Part 2
"Reflections on Monetary Policy 25 Years After October 1979" – read comments by Ben S. Bernanke, Alan S. Blinder, and Bennett T. McCallum
Blanchard, O. and Gali J, 2006) "Real Wage Rigidities and the New Keynesian Model"
   www.crei.cat/people/gali/pdf_files/bg06jmcb.pdf

Topic 7
   Monetary policy in practice; inflation targeting
Leu, S and Sheen, J. (2006) "Asymmetric Monetary Policy in Australia" Economic Record, September
Ireland, P. (2007) "Changes in the federal reserve's inflation target: causes and consequences" Journal of Money, Credit & Banking 39 (Dec)