MACQUARIE UNIVERSITY

FACULTY OF BUSINESS AND ECONOMICS

ECON844
Monetary & Financial Policies

Semester 1, 2009

Department of Economics

Unit coordinator	Professor Jeffrey Sheen
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Consultation hours	Wednesday 2-4pm
Lectures	Tuesdays 6-9pm C5A 404 beginning 24 February

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1. AIMS AND NATURE OF THE COURSE

This elective unit in the postgraduate programs in the Faculty of Business and Economics will help provide you with the necessary tools to analyze current issues in monetary theory and policy.

In this subject, the intention is:

- to understand the what drives the relationships between key macroeconomic economic indicators (eg inflation, growth, interest rates, stock market indices) that should be part of every manager's information set; and
- to understand the design and constraints of monetary policy, in normal times and during a crisis; and
- too provide a framework for understanding modern dynamic stochastic general equilibrium models

This unit examines a number of issues in monetary theory and policy. We begin with a quick refresher survey of the workhorse models in macroeconomics – ISLM, ASAD, and then develop them for intertemporal modelling. Issues in monetary and fiscal policy design are then discussed, particularly in regard to the global financial crisis of 2008-9.This leads to the development of the key models of monetary economies in professional use today. They are based on what are known as "dynamic stochastic general equilibrium" (DSGE) 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 are often referred to as "New Keynesian" models. The basic 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. A key issue is how to determine optimal monetary policy, and we will begin to examine how one thinks about this.

3. ASSESSMENT

Summary

Type	Weighting	Submission date
1. 2 online quizzes	15%	6-10 March, 27-31 March
1. 1 term paper	15%	Tuesday 26 May 6pm
2. Mid-term test	30%	Tuesday 8 April 6-8pm.
3. End-of-term examination	40%	TBA (Exam period 10 June – 26 June)
Total	**100%**	

Details

- **2 online quizzes.**

These will be available on Blackboard under "Quizzes" on Fridays (6 March and 27 March respectively) at 2:30pm. They will have to be completed online by the following Tuesday (10 March and 31 March respectively at 1pm.

You must do these quizzes alone. Do not allow anyone to see your answers, and do not ask anyone to help you do yours. You will have to do 20 multiple-choice questions, randomly selected and ordered for you from a large set. Make sure that you allocate sufficient time to do them. Do not expect to complete them at the last minute—computers are not always available. Computer unavailability is not an acceptable excuse. NOTE: Provided a quiz is still available and not yet SUBMITTED, you can correct any previously saved answer. On the assignment page, you will find two buttons in the bottom right hand corner -"Save", "Submit". You may save your work by clicking on the "Save" button and continue the assignment at a later time. *DO NOT CLICK on the "SUBMIT" button* unless you have completed the assignment and want to get it graded. You can submit the assignment only "ONCE". The quizzes will be computer-marked. After the assignment is submitted, you will be able to see your score, and the GRADE is FINAL. *It cannot be helped if you mistakenly submit your quiz too early.* If you do not submit answers by the deadline for a quiz, you will not get marks.

- **One term paper** due Tuesday 26 June 2009 at 6pm at the lecture.

   Topic: *The global financial crisis of 2008-9 is one of the biggest tests faced by central bankers for a long time. Explain the origins of the crisis, why and how it has affected all economies, the appropriate response and limitations of monetary policy, and any improvements in design that you think should be considered.*

- **One mid-term test** (two hours) on Tuesday 8 April 2009, 6-8pm in C5A 404.. 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. UNIT WEB SITE (ONLINE MATERIAL)

You can access the ECON844 web site from anywhere on the Internet. To login you need a Username and password. Your ECON844 Username will be your standard Macquarie student username, which is your University Student Number. The letter you received from the University after enrolment will also have informed you of your initial password. For security reasons we suggest you change your password when you first login. If you forget your password or your account has been disabled, it can be reset by the Information Technology Services (ITS) Helpdesk. If you have not received the letter, contact the ICS Helpdesk.

5. ENQUIRIES AND PROBLEMS

Administrative
If you have forgotten your password for the web site, the ITS Help desk can reset it.
Student Enquiry Centre - if you are sick or experience misadventure such that you are unable to complete an item of coursework (multiple choice tests, for example), go to the centre to lodge your application. Also email your lecturer with the problem as soon as possible
Academic
Please consult me at any time if there is something you are unsure of.
My office hours are on Wednesdays 2-4pm. All details are on the first page.

6. THE DANGERS OF PLAGIARISM AND HOW TO AVOID THEM

The integrity of learning and scholarship depends on a code of conduct governing good practice and acceptable academic behaviour. One of the most important elements of good practice involves acknowledging carefully the people whose ideas we have used, borrowed, or developed. All students and scholars are bound by these rules because all scholarly work depends in one way or another on the work of others.
Therefore, there is nothing wrong in using the work of others as a basis for your own work, nor is it evidence of inadequacy on your part, *provided you do not attempt to pass off someone else's work as your own.*

2. TEXTS

For the first third of the course, we will use selected chapters from:

Olivier Blanchard & Jeffrey Sheen *Macroeconomics* Pearson, 2nd Australasian edition, 2006

For the rest of course, we will use selected chapters from

Carl E Walsh, *Monetary Theory and Policy* MIT Press, 2nd edition, 2003

Jordi Gali, *Monetary Policy, Inflation and the Business Cycle*, Princeton Press, 2008

Michael Wickens *Macroeconomic Theory* Princeton Press, 2008

A useful book for your essay is:

Robert Shiller *The Subprime Solution*, Princeton Press, 2008.

7. TOPIC GUIDE

Topic 1

Quick refresher on ISLM, ASAD macroeconomic models; the role of expectations in financial markets, and for consumption and investment

* Blanchard & Sheen Chapters 4-9, 14-17.

Topic 2

The macroeconomics of financial crises

* Blanchard & Sheen 2009 3rd edn. New Chapter 22 *(I will distribute this to you).*

* Blanchard & Sheen 2006, Chapters 22-23

Robert Shiller *The Subprime Solution* Princeton Press 2008

John Taylor, *The financial crisis and the policy responses: an empirical analysis of what went wrong*, http://www.nber.org/papers/w14631, 2009

Robert Lucas Jnr, *The Current Financial Crisis*, Universidad Torcuato di Tella 2008 *(slides from a talk, I will distribute to you)*

Topic 3

Fiscal constraints on monetary policy; the design and implementation of monetary policy

* Blanchard & Sheen 2006, Chapters 24-27

* Walsh Chapters 2 (2.1-2.3) , 3 (3.1-3.3)

or

* Wickens Chapter 5 (5.1-5.5)

Topic 4
Basic monetary models
* Walsh Chapters 2 (2.1-2.3) , 3 (3.1-3.3), 4 (4.1-4.4)
or
* Gali Chapter 2
or
* Wickens Chapters 2, 4, 8
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 5
Solving forward-looking models
Wickens Chapter 15 (Mathematical appendix)

Topic 6
Real business cycle theory; the New Keynesian model with nominal rigidities.
* Walsh Chapter 5 (5.1-5.3)
or
* Gali Chapters 2-4, 6
or
* Wickens Chapters 9, 13, 14
David Romer, Advanced Macroeconomics, McGraw Hill, 3rd ed, 2006, Chapter 4
Rebelo, S. (2005) "Real Business Cycle Models: Past, Present and Future" Scandinavian Journal of Economics 107 (2), 217–238.
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
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.