

ECON844 Monetary & Financial Policies

Semester 1, 2011

Department of Economics

Unit coordinator	Professor Jeffrey Sheen
Building and Room	E4B 430
Phone number	9850 7287
Email	jsheen@efs.mq.edu.au
Consultation hours	Wednesday 2-4pm
Lectures	Tuesdays 6-9pm C5A 226 beginning 22 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 and its subsequent effects. We shall also consider financial regulation and its impact on the financial system and the real economy. The second half of the unit is about 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.

2. ASSESSMENT

Summary

Type	Weighting	Submission date
1. 1 online quiz	10%	29 March – 1 April
2. Mid-term test	30%	Tuesday 5 April 6-8pm.
3. 1 term paper	20%	Tuesday 24 May 6pm
4. End-of-term examination	40%	TBA in June
Total	100%	

Details

- **1 online quiz.**

This will become available on Blackboard under “Quizzes” on 29 March at 2:30pm. It will have to be completed online by 1 April at 6pm.

You must do this quiz alone. Do not allow anyone to see your answers, and do not ask anyone to help you do yours. You will have to do 30 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 the 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 quiz 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 the quiz, you will not get marks.

- **One term paper** due Tuesday 24 May 2011 at 6pm at the lecture.
Topic: *In what ways was the Great Recession of 2008-11 different to the Great Depression of the 1930s? Compare the causes, outcomes and policy responses in one or more countries.*
 - **Length:** No more than 10 pages of typed text, 12 point, 1.5 line spaces, A4.
- **One mid-term test** (two hours) on Tuesday 5 April 2010, 6-8pm in C5A 226. 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.

3. 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. If you have not received the letter, please contact the ITS Helpdesk. For security reasons we suggest you change your password when you first login.

All lecture slides should be available on the Blackboard site 24 hours before the lecture.

4. 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 me 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.

5. 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.*

6. TEXTS

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

Olivier Blanchard & Jeffrey Sheen *Macroeconomics* Pearson, 3rd Australasian edition, 2009

The third edition has a lot of new material that will be directly relevant to the unit – in particular on the financial crisis.

For the rest of course, we will connect with selected chapters from:

Carl E Walsh, *Monetary Theory & Policy* MIT Press, 2nd ed , 2003

Other reference books include:

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

Michael Wickens *Macroeconomic Theory* Princeton Press, 2008

Useful books for your essay are:

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

Mathias Dewatripont, Xavier Freixas & Richard Portes (eds.) *Macroeconomic Stability and Financial Regulation: Key Issues for the G20* 2 March 2009. Free e-book:

<http://www.voxeu.org/index.php?q=node/3167>

Carmen M. Reinhart & Kenneth S. Rogoff *This Time Is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2010

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 2009 Chapters 4-9, 14-17.

Glenn Stevens et al (2010) “Fifty Years of Monetary Policy: What Have We Learned?”, Bank for International Settlements, RBA Anniversary Conference: www.rba.gov.au/publications/confs/2010/index.html

Topic 2

The macroeconomics of financial crises

Blanchard & Sheen 2009 Chapter 22-23

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

Hall, Robert E. 2010. "Why Does the Economy Fall to Pieces after a Financial Crisis?" *Journal of Economic Perspectives*, 24(4): 3–20. www.aeaweb.org/issue.php?journal=JEP&volume=24&issue=4

Woodford, Michael (2010). "Financial Intermediation and Macroeconomic Analysis." *Journal of Economic Perspectives*, 24(4): 21–44.

Joseph Stiglitz (2009) "The Current Economic Crisis and Lessons for Economic Theory" *Eastern Economic Journal*, 35(3), June, pp. 281-296. <http://www2.gsb.columbia.edu/faculty/jstiglitz/Crisis.cfm>

Jaime Caruana (2010) "Financial Stability: 10 Questions and About Seven Answers", Bank for International Settlements, RBA Anniversary Conference: www.rba.gov.au/publications/confs/2010/index.html

Topic 3

Fiscal constraints on monetary policy; inflation and deflation; government debt and inflation; the design and implementation of monetary policy and financial regulation

Blanchard & Sheen 2009, Chapters 25-28

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

or

Wickens Chapter 5 (5.1-5.5)

Olivier Blanchard, Giovanni Dell’Ariccia, and Paolo Mauro (2010) "Rethinking Macroeconomic Policy" IMF Staff Position Note, February, www.imf.org/external/pubs/cat/longres.cfm?sk=23513.0

John Cochrane (2011), "Understanding fiscal and monetary policy in the great recession: Some unpleasant fiscal arithmetic." *European Economic Review*, January 55 2-30

Glenn Stevens (2011) "The Role of Finance" *The Economic Record*, March 2011, pp1-11.

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

Bennett McCallum, & Ed. 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, Ch 4

Sergio Rebelo (2005) “Real Business Cycle Models: Past, Present and Future” *Scandinavian Journal of Economics* 107 (2), 217–238.

Larry Christiano, Martin Eichenbaum & C.Evans (2005) “Nominal Rigidities and the Dynamic Effects of a Shock to Monetary Policy” *Journal of Political Economy*, vol. 113, no. 1

Richard Clarida, Jordi Gali, and Mark. Gertler (1999): “The Science of Monetary Policy: A New Keynesian Perspective,” *Journal of Economic Literature*, 37(4), 1661—1707.