ECON844
Monetary & Financial Policies

Session 2, 2012

Department of Economics

<table>
<thead>
<tr>
<th>Unit coordinator</th>
<th>Professor Jeffrey Sheen</th>
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<tr>
<td>Building and Room</td>
<td>E4B 430</td>
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<tr>
<td>Phone number</td>
<td>9850 7287</td>
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<tr>
<td>Consultation hours</td>
<td>Wednesday 2-4pm</td>
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<td>Lectures</td>
<td>Thursdays 6-9pm Room: W6B 325</td>
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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 and macroprudential regulation policy, in normal times and during a crisis; and
- to 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 design 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

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<tr>
<th>Summary</th>
<th>Weighting</th>
<th>Submission date</th>
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<tbody>
<tr>
<td>1. 1 online quiz</td>
<td>10%</td>
<td>27 August (6pm)</td>
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<td>2. Mid-term test</td>
<td>30%</td>
<td>13 September (6pm)</td>
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<td>3. 1 essay</td>
<td>20%</td>
<td>1 November (6pm)</td>
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<td>4. End-of-term examination</td>
<td>40%</td>
<td>TBA</td>
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<td><strong>Total</strong></td>
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Details

• 1 online quiz.
This will become available on iLearn under “Quizzes” on 24 August at 1pm. It will have to be completed online by 27 August 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 essay due at 6pm at the lecture.

Topic choices:

EITHER:
1. Describe the financial problems faced by Greece in 2012, and explain how the solutions in place may or may not solve these. What lessons are there for other countries?

OR:
2. What are the factors determining systemic risk in the financial sector? Explain how macroprudential regulation can be designed to minimize this risk.

Length: No more than 10 pages of typed text, 12 point, 1.5 line spaces, A4.
• **One mid-term test** (two hours) on 13 September 2012, 6pm in our lecture room. The mid-session 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) (time and place to be announced). The end-of-session 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 on iLearn from anywhere on the Internet. To login you need a Username and password. All lecture slides should be available on the iLearn site at least by midday of 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 part of the course, we will use selected chapters from:


*The third edition has a lot of material that will be directly relevant to the unit – in particular on the financial crisis. A fourth edition is being written now, and the lectures will include extra material from that.*

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


Other reference books include:


Useful books for your essay are:


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.

**Topic 2**

*The macroeconomics of financial crises; systemic risk and macroprudential regulation*

Blanchard & Sheen, 2009 Chapters 22-23

[http://www.nber.org/papers/w14631](http://www.nber.org/papers/w14631),


Carmen Reinhart & Ken Rogoff (January 2010) NBER WP15639, Financial Stability Review (March 2012), RBA  


**Topic 3**

*The design and implementation of monetary policy and financial regulation; fiscal constraints on monetary policy; inflation and deflation; government debt and inflation; the intertemporal government budget constraint.*

Blanchard & Sheen 2009, Chapters 25-28

Walsh Chapters Ch 4.1-3

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,  

**Topic 4**

*Basic monetary models; money in utility; optimal rate of inflation*

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


**Topic 5**

*Solving forward-looking models, 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, 15 (Mathematical appendix)

David Romer, Advanced Macroeconomics, McGraw Hill, 3rd ed, 2006, Ch 4


Jeffrey Sheen and Ben Wang; “Optimal Monetary Policy Design for an Imperfect Economy”, 2012, Macquarie University draft.