



# ECON844 Monetary & Financial Policies

## Semester 1, 2010

*Department of Economics*

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<b>Consultation hours</b>	Wednesday 2-4pm
<b>Lectures</b>	Tuesdays 6-9pm E6A 108 beginning 23 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. 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. 2 online quizzes	15%	5-9 March, 26-30 March
1. 1 term paper	15%	Tuesday 25 May 6pm
2. Mid-term test	30%	Tuesday 6 April 6-8pm.
3. End-of-term examination	40%	TBA in June
<b>Total</b>	<b>100%</b>	

### *Details*

- **2 online quizzes.**

These will be available on Blackboard under “Quizzes” on Fridays (5 March and 26 March respectively) at 2:30pm. They will have to be completed online by the following Tuesday (9 March and 30 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 25 May 2010 at 6pm at the lecture.

Topic: *Explain the origins of the global financial crisis, why and how it has affected all economies, how well it was addressed by policy-makers, and what challenges lie ahead.*

- **Length:** No more than 10 pages of typed text, 12 point, 1.5 line spaces, A4.

- **One mid-term test** (two hours) on Tuesday 6 April 2009, 6-8pm in E6A 108. 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 will 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, 3<sup>rd</sup> 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, 2<sup>nd</sup> 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>**

## 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](http://www.rba.gov.au/publications/confs/2010/index.html)

### Topic 2

*The macroeconomics of financial crises*

\* Blanchard & Sheen 2009 Chapter 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*, 2009 <http://www.nber.org/papers/w14631>,

The Economist January 22 2009, “Greed and Fear”

\*Carmen M. Reinhart & Kenneth S. Rogoff, “Growth in a Time of Debt” NBER Working Paper 15639, January 2010 <http://www.nber.org/papers/w15639>

\*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](http://www.rba.gov.au/publications/confs/2010/index.html)

### **Topic 3**

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

\* 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](http://www.imf.org/external/pubs/cat/longres.cfm?sk=23513.0)

### **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, 3<sup>rd</sup> 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.