

2014

Monetary Economics: Theory

Course Instructor: Alfred V Guender

Lecture Hours: To be arranged

Course Content:

This course surveys a number of important topics in monetary and financial theory from both a macroeconomic and microeconomic perspectives. A few topics such as credit rationing and the provision of liquidity in the financial sector draw heavily on microeconomics. The lectures cover a range of very diverse topics. They include a discussion of the transmission mechanism of monetary policy, banking issues such as the role of the capital asset ratio and the role of liquidity, the implementation of monetary policy in a channel-based interest rate system, the term structure of interest rates, and the tax smoothing hypothesis. The topical nature of the course is brought out further by a discussion of the uncovered interest rate puzzle from two different perspectives - economics vs. finance - and the recent drive towards currency unions.

This monetary theory course complements the Monetary Policy course (Guender/Ascari) which was offered over the summer 2014 at FU Berlin. It should be of interest to those students keen to specialize in monetary macroeconomics.

This course aims at:

- providing an overview of important topics in monetary and financial theory in the context of the recent financial crises
- highlighting the crucial role played by financial markets in transmitting monetary impulses to the real sector of the economy
- explaining the operating regime of a central bank.

This is a lecture-based course. As a result, students' understanding of the material is examined in a compulsory final exam. Research-oriented students have the **option** of writing a research paper. The **due date** of the research paper is **January 15th**. Students wishing to partake of this option must inform me before taking the final examination.

The timetable of lectures will be announced shortly. The course will run from December 1st to December 19th. The final exam has been scheduled for December 19th (subject to change).

Assessment: Final Exam 100% or Final Exam 67% and Research Paper 33%
Topic: *Issues in the Regulation of Banks*

Useful Books: Carl Walsh, *Monetary Theory and Policy*, MIT Press, 1998, 2003, 2010.

Lucio Sarno and Mark Taylor, *The Economics of Exchange Rates*, Cambridge University Press, 2002.

Friedman & Hahn (eds), *Handbook of Monetary Economics*, North Holland, 1990, Vols I and II.

John Cochrane, *Asset Pricing*, Princeton University Press, 2001.

Abbreviations:

*	required reading		
AER	American Economic Review	JIE	Journal of International Economics
JEL	Journal of Economic Literature		
JEP	Journal of Economic Perspectives	JF	Journal of Finance
JMACRO	Journal of Macroeconomics	JMCB	Journal of Money, Credit, and Banking
JME	Journal of Monetary Economics	JPE	Journal of Political Economy
QJE	Quarterly Journal of Economics	RESTAT	Review of Economics and Statistics

List of Topics:

1. The Transmission Mechanism of Monetary Policy: The “Old(?)” Keynesian System

*Tobin, J., “A General Equilibrium Approach to Monetary Theory”, *JMCB* (February 1969).

*Bernanke B. & Blinder, B., “Credit, Money and Aggregate Demand”, *AER* (May 1988).

Bernanke, B., Gertler, M. & Gilchrist, S., “The Financial Accelerator and the Flight to Quality,” *RESTAT*, 78, No.1, 1996, pp. 1-15.

* Gilchrist, S. & Zakrajsek, E., “Credit Spreads and Business Cycle Fluctuations,” *AER* (September, 2012).

2. Implementation of Monetary Policy: Some Theoretical and Practical Considerations

*Henckel, T., Ize, A. & Kovanen, A., “Central Banking Without Central Bank Money, IMF Working Paper 92, 1999.

Woodford, M., “Monetary Policy in the Information Economy,” in: *Economic Policy for the Information Economy*, Kansas City: Federal Reserve Bank of Kansas City, 2001, pp. 297-370.

3. Monetary Policy and Financial Regulation in Turbulent Times:

*Hanson, S., Kayshap, A. and J. Stein, “A Macroeconomic Approach to Financial Regulation,” *JEP*, 25, No. 1, 2011, pp. 3-28.

Stella P., “The Federal Reserve Balance Sheet and Why It Matters,” *IMF Working Paper*, Sept. 2009

4. Banking and Financial Structure

*Diamond, D.W. & Dybvig, P.H., "Bank Runs, Deposit Insurance, and Liquidity," *JPE*, Vol. 91, No. 3, 1983, pp.401-419.

*Peek, J. & Rosengren, E., "The Capital Crunch: Neither a Borrower or a Lender Be," *JMCB*, Vol. 27, No. 3, 1995, pp.625-638.

Kishan R. and Opiela T., "Bank Size, Bank Capital, and the Bank Lending Channel," *JMCB*, Vol. 32. No. 1, 2000, pp. 121-141.

5. Credit Markets and Credit Rationing

Jaffee, B. & Stiglitz, J., "Credit Rationing", in *Handbook of Monetary Economics*, Vol. 2, Ch. 16.

*Stiglitz, J. & Weiss, A., "Credit Rationing in Markets with Imperfect Information", *AER*, June, 1981.

*Walsh, Ch. 7.2.

Bernanke, B.S., "Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression", *AER*, June 1983.

6. The Term Structure of Interest Rates

Begg, D., *The Rational Expectations Revolution in Macroeconomics*, Johns Hopkins, 1982, Ch. 8.

*Mankiw, G. & Miron, J., "The Changing Behavior of the Term Structure of Interest Rates," *QJE*, (May 1986).

*McCallum, B., "Monetary Policy and the Term Structure of Interest Rates," NBER Working Paper #4938, 1994.

Shiller, R.J., "The Term Structure of Interest Rates," in *Handbook of Monetary Economics*, Vol. 1, Ch. 13.

* Guender, A.V. and Wu G., "Operating Procedures and the Expectations Theory of the Term Structure of Interest Rates: The New Zealand Experience from 1989 to 2008," *Applied Financial Economics* (2012).

Walsh, Ch. 10.4.

7. Monetary Policy and Exchange Rate Behavior:

A. The UIP Puzzle from the Perspective of Economics

* Chinn, M. and Meredith, G., “Monetary Policy and Long Horizon Uncovered Interest Rate Parity,” *IMF Staff Papers* (2004).

McCallum, B. T., “A Reconsideration of the Uncovered Interest Parity Relationship,” *JME* (1994).

* Guender, A.V., “International Evidence on the Role of Monetary Policy in the Uncovered Interest Rate Parity Puzzle,” Manuscript, University of Canterbury, 2014.

B. The UIP Puzzle from the Perspective of Financial Economics

* Backus, D., Foresi S., and Telmer C., “Affine Term Structure Models and the Forward Premium Anomaly,” *JF* (February 2001).

* Backus, D. Giavazzo, Telmer, and Zin, “Monetary Policy and the UIP Puzzle,” Unpublished Manuscript, 2010.

8. Currency Unions

* Beetsma, R. and Massimo, G., “The Macroeconomic Costs and Benefits of the EMU and other Monetary Unions: An Overview of Recent Research,” *JEL*, (September 2010).

*Dixit, A. and Lambertini, L., “Symbiosis of Monetary and Fiscal Policies in a Monetary Union,” *JIE* (2003). (Working paper version is actually better).

9. Money and Public Finance

Mankiw, G. “The Optimal Collection of Seigniorage: Theory and Evidence”, *JME* (September 1987).

* Guender A. V. and Lees, K “The Revenue Smoothing Hypothesis: Evidence from New Zealand,” *JMACRO* (June 1999).

*Walsh, Ch. 4.4.

10. The Sovereign Debt Crisis

Contessi, S., “An Application of Conventional Sovereign Debt Sustainability Analysis to the Current Debt Crisis,” *Federal Reserve Bank of St. Louis Review* (May/June 2012).