

# Monetary Economics

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## Course description

Monetary Economics is a two-semester course designed for the fourth-year students studying Economics, and Finance and Banking. It is one of the core courses taught to the fourth-year students at the ICEF and prepares them for the University of London final examination on the subject.

The course focuses on the issues of monetary policy implementation in the closed and open economy contexts. The Fall semester adopts the domestic economy perspective and covers topics of money creation and monetary transmission mechanisms, inflation and expectations, neutrality of money. The material provides students with the theoretical background on the classical and Keynesian approaches to the monetary policy and discusses their empirical evidence. The Spring semester examines the term structure of the interest rates and extends discussion to the international dimension. The most important topics of open monetary economics are presented: the interest rate and purchasing power parity conditions, the Dornbusch overshooting model, the exchange rates regimes.

## Teaching objectives

Monetary Economics course provides students with the theoretical building blocks that are needed for an understanding of the monetary theory and surveys the issues in the present-day monetary policy implementation faced by the central banks. The course equips students with the necessary background to analyze problems involving the determination of interest and exchange rates in the economy as well as with the understanding of what central banks can do to improve the economic performance through the use of the monetary policy instruments.

The course is a part of the University of London external program and is taught in English.

## Teaching methods

The following methods and forms of study are used in the course:

- lectures
- classes

- written home assignments (1 per 1–2 weeks)
- teachers' consultations (2 hours per week)
- self study

The course is taught during two semesters of the 4-th year of education at ICEF. Lectures are designed to help students to understand the main concepts of the course. The classes are used to illustrate the theory with references to policy issues, empirical studies and quantitative tasks. The home assignments have two goals: they prepare the students for the external examination, and they are used to monitor the students' progress in the course. The home assignments have the format of the University of London examination: essay questions (open-end questions) to analyse a particular problem in detail, quantitative problems and true/false/uncertain evaluations of given statements.

## Assessment

There are several forms of current, intermediate and final control in the course. The current control includes written home assignments and class teachers' evaluation of the student participation in the class discussions. The intermediate control includes the mid-term test in the Fall semester and the Winter exam. The final control includes the final exam in April and the University of London examination.

## Grade determination

In the Fall semester the grade is given on the basis of the following criteria:

- 10% — home assignments
- 5% — class activity
- 35% — mid-term examination
- 50% — winter examination

The final grade is given on the basis of the following criteria:

- 10% — home assignments in the Spring semester
- 5% — class activity in the Spring semester
- 35% — the first semester grade
- 50% — the final exam

## Main reading

1. Lewis M. and Mizen P. Monetary Economics. Oxford. 2002. (LM).
2. Goodhart C. Money, Information and Uncertainty. MacMillan, 1989. (G)
3. Krugman P. and M. Obstfeld. International Economics: Theory and Policy. Addison-Wesley, 2003. (KO)
4. Miller R., Van Hoose D. Modern Money and Banking. 3d ed., L., 1993. (Русский перевод: М.,2000) (MH)
5. Mishkin F. The Economics of Banking and Financial Markets. 6th ed. rev., Boston., 2003. (Mishkin) Русский перевод: Мишкин Ф. Экономическая теория денег, банковского дела и финансовых рынков. М., 1999.

## Internet resources and databases

1. <http://econ.lse.ac.uk/courses/ec321/>
2. <http://mief.hse.ru>
3. [http://wps.aw.com/aw\\_mishkin\\_econmbfm\\_8](http://wps.aw.com/aw_mishkin_econmbfm_8)
4. [http://wps.aw.com/aw\\_krgmnobstf\\_interecon\\_7](http://wps.aw.com/aw_krgmnobstf_interecon_7)

## Course outline

### Basic concepts of Monetary Economics

#### 1. The nature of money

- Defining money by its functions
- Advantages of monetary over the barter economy
- Types of money

*LM, ch. 1; G, ch. 2*

#### 2. Demand for money

- The quantity theory demand for money
- The Keynes' speculative demand for money
- The transactions theories of money demand

- Baumol-Tobin model and the Tobin's model of portfolio selection
- Empirical evidence

*LM, ch. 5–6; 11, 12; G, ch. 3, 4; Laidler D. The Demand for Money. Harper Collins, 1993.*

### 3. Money supply

- Creation and control of the monetary base by the central bank
- The banking system and financial intermediation
- The base-multiplier approach to money supply determination
- Monetary policy instruments

*G, ch. 5, 6 and 10; MH, ch. 4, 5, 6, 8, 9; Mishkin. ch. 15, 16*

### 4. Classical theory of money

- The classical dichotomy and monetary neutrality
- Money in general equilibrium
- Walras's law and the Patinkin's critique
- The Real-Balance Effect

*LM, ch. 3–4*

## Monetary Policy in a Closed Economy

### 5. Money, Inflation and Welfare

- Real and nominal interest rates
- High inflation and hyperinflation
- The Laffer Curve and the inflation tax
- The welfare costs of inflation and the optimal quantity of money

*LM, ch. 7; MH, Ch. 21*

## 6. Classical models and monetary policy

- The classical model revisited
- Real business cycle theory
- Lucas misperception model
- Cash-in-advance models

*Hoover, K.D. The New Classical Macroeconomics. Blackwell, 1988, ch. 3. Plosser, C. Understanding Real Business Cycles, Journal of Economic Perspectives, 1989, Summer.*

## 7. Monetary policy in Keynesian models

- Keynesian aggregate supply function and the Phillips curve
- Menu costs and sticky prices
- Multi-period pricing model

*LM, ch. 5*

## 8. Conduct of monetary policy in a closed economy

- Policy ineffectiveness proposition (PIP)
- Rational expectations models and monetary policy
- Lucas critique
- Time inconsistency and inflation bias
- Central bank independence: a discussion
- Friedman's rule of constant money growth

*LM, ch. 9 and 10; MH. Ch. 22; 24; 25; 26*

## 9. The term structure of interest rates

- The yield curve, bond prices and the rate of return
- The expectations hypothesis
- The segmentation hypothesis
- The preferred habitat theory

*G, ch. 11, LM, ch. 5; Mishkin. ch. 6*

## Monetary Policy in Open Economy

### 10. Balance of payments, nominal and real exchange rates

- Income accounting in an open economy
- The balance of payments
- Nominal exchange rates
- Real exchange rates

*KO, ch. 12; LM, ch. 15*

### 11. Prices and exchange rates

- The law of one price (LOOP)
- Purchasing power parity (PPP)
- Relative purchasing power parity
- Empirical evidence on PPP and the Balassa-Samuelson theory
- The monetary approach to the exchange rate determination

*KO, ch. 12 and 15*

### 12. Money, interest rates and exchange Rates

- Uncovered Interest Parity (UIP)
- Covered Interest Parity (CIP)
- Money Market Equilibrium in an open economy

*KO, ch. 13 and 14; Mishkin, ch. 8*

### 13. Monetary policy and output in an open economy

- Exchange rate regimes and monetary policy
- The monetary policy coordination amongst countries
- The AA-DD model of an open economy

*KO, ch. 16; MH. Ch. 27, 28, 29*

**14. Exchange rate regimes and monetary unions**

- The Gold standard
- The Bretton Woods system
- Flexible exchange rate system
- The currency crises and the ‘vanishing’ intermediate regimes
- Costs and benefits of a monetary union. European Monetary Union

*KO, ch. 18, 19, 20; LM, ch. 15*

**15. Monetary policy in an open economy**

- Instruments of monetary policy in the small open economy
- The exchange rate as an intermediate target
- Inflation targeting under flexible exchange rate regime

*Mishkin, ch. 18, 20*

**Distribution of hours**

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
1.	The nature of money	20	4	4	12
2.	Demand for money	20	4	4	12
3.	Money supply	20	4	4	12
4.	Classical theory of money	28	6	6	16
5.	Money, inflation and welfare	24	4	4	16
6.	Classical models and monetary policy	28	6	6	16
7.	Monetary policy in Keynesian models	24	6	6	12
8.	Conduct of monetary policy in a closed economy	20	4	4	12
9.	The term structure of interest rates	20	4	4	12
10.	Balance of payments, nominal and real exchange rates	20	4	4	12
11.	Prices and exchange rates	20	4	4	12

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
12.	Money, interest rates, and exchange rates	20	4	4	12
13.	Monetary policy and output in an open economy	20	4	4	12
14.	Exchange rate regimes and monetary unions	20	4	4	12
15.	Monetary policy in an open economy	20	4	4	12
Total:		324	66	66	192