

Monetary Economics

Course info

Fall term and 1st half of Winter Term is taught by M. Udara Peiris, Ph.D., Associate Professor at ICEF

2nd half of Monetary Economics Winter term is taught by Vladimir Sokolov, Ph.D., Associate Professor at ICEF.

Prerequisites

This course is an intermediate (advanced undergraduate) level macroeconomics course. However, the course will focus on the microfoundations of macroeconomic issues and modelling. This means explicitly deriving aggregate behaviour from individual preferences and behaviour.

A good knowledge of 3rd year Macroeconomics is necessary. Perhaps more importantly, a thorough knowledge and understanding of the General Equilibrium section in the 3rd year Microeconomics course is needed. Students are strongly advised to revise this section of the 3rd year course before the first lecture in Monetary Economics. Students should be comfortable in setting up an individual maximisation problem (utility function, budget constraints, market clearing conditions), setting up a Lagrangian of the maximisation problem, deriving first order (optimality) conditions, deriving individual demand functions from the Lagrangian and finally solving for prices from market clearing conditions. To be precise, students should be comfortable in writing down and solving a two period economy with 2 agents and a single good each period, each having endowments in each period, trading a bond between the two agents and solving for the equilibrium interest rate.

To ensure that students have a comfortable grasp of the above, they are strongly advised, before the first lecture, to go through Section 1 and Section 2.1 (all pages up to and including page 7) of:

<https://www.dropbox.com/s/bxfiafvyl81dkye/Money%20in%20GE%20week%204%20note.pdf?dl=0>

Abstract

Monetary Economics is a two-semester elective course for the fourth-year students studying Economics, and for those in Economics and Finance and Banking and Finance. It is one of the core courses taught to the fourth-year students at the ICEF. The content of the corresponding University of London course will be covered entirely, but will constitute approximately 70% of the material of the ICEF course.

The course focuses on the issues of monetary policy implementation in a closed economy contexts. The Fall semester covers topics of money creation and monetary transmission mechanisms, inflation and expectations, neutrality of money and introduces the Real Business Cycle Model. The first half of the winter term will cover the classical and Keynesian approaches to the monetary policy and discusses their empirical evidence. The second half of the winter semester examines time inconsistency in monetary policy, uncertainties in monetary policy design and the term structure of interest rates.

Learning Objectives and Outcomes

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 student should be able to apply professional knowledge and skills acquired while studying the course in practical areas, including academic research, work in financial institutions, industry, state governance.

Methods of Instruction

Students may be used to a strict Didactic teaching approach in the past. This course takes a mix of the Socratic and Didactic approach to teaching, with lectures emphasising the Socratic. For those unfamiliar with this, please refer to: <http://www.collegeenglishbooks.com/two-models-of-teaching-learning.html>.

The fall term presents many different models that in and of themselves are important for UoL exam (and exam-type) questions. However, they will need to be understood not in isolation but collectively as a means to understand monetary phenomena. Students are expected to develop an understanding how the collection of models and results can be used to analyse real-world phenomena. If students are unclear how material throughout the term are connected, they are encouraged to ask the lecturer.

The following methods and forms of study are used in this course: lectures, classes, a home assignment, teachers' consultations (2 hours per week) and self-study. The course is taught during two semesters of the 4th year of education at ICEF. Lectures are designed to help students to understand the main concepts of the course. Lectures will be given primarily through slides, with discussions, academic articles and videos to compliment and reinforce concepts. All content in lectures are assessable.

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 are used to monitor the students' progress in the course and they prepare the students for the external examination. The home assignment for fall semester will consist of asking students to analyse a recent phenomenon through a dataset.

The mid-term test and final exams for fall semester will have a structure loosely based on the UoL exams. Students should expect the standard of the course to be higher than the UoL.

There are intermediate and final control in the course: • The intermediate control includes the mid-term test in the Fall semester and the Fall final exam. • The final control includes the final exam in April and the University of London examination.

The passing grade is 40%. Students must have an overall score of 40% or more overall in the Fall semester (weighted average of mid-term test, homework assignment and Fall examination) to pass the Fall semester. The passing grade is 40%. Students must have an overall score of 40% or more overall in the Winter semester to pass the Winter semester. To pass the course overall, students must have 40% or more in the combined weighted score of the Fall term and Winter term.

There is no fixed distribution of grades, however international standards and previous experience in the course suggest that the overall pass-rate is proportional to average lecture and class attendance. Grading for both home assignments and exams are typically based on a 5 or 10 point scale per question. In other words, students are awarded marks on a cardinal scale reflecting their level of understanding of the material. This contrasts with an ordinal scale where student scores reflect relative rank among students.

Grading System and Knowledge Assessment

Material from the fall term and first half of winter term will be examined in the UoL style and one based on real world articles. For the latter, students are typically expected to read a recent news article and

form a constructive argument based on material learnt in the course. Responses are expected to look at the material in the article in several view points and argue which one is the most appropriate. This requires students to compare and contrast the various models and approaches learnt in the course.

Fall Term Homework assignments

Homework assignments in the fall term will provide practice to students on the approach used in the exams. Homework assignments will be individual, however it is encouraged for students to work together on it. There is a fine line between copying and arriving at answers collectively. All submissions should show evidence of individual work and evidence of copying will be punished severely. The names of all classmates that home assignments are discussed with must be listed on the front of submissions.

In other words, collaboration is encouraged in this course, but you must follow the rules. If you do your homework in a group, be sure it works to your advantage rather than against you. Good grades for homework you have not thought through will translate to poor grades on exams. You must turn in your own write ups of all problems, and, if you do collaborate, you must write on your solution sheet the names of the students you worked with. Failure to do so constitutes plagiarism.

Grade Determination

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

15% Homework assignment;

20% mid-term test;

65% Fall examination.

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

25% Winter mid-term test;

5% class activity in the Winter semester;

20% the Winter final exam.

50% the Fall grade

Sample materials for knowledge assessment are available in ICEF Information system at <https://icef-info.hse.ru>.

Required reading

Fall Semester: The CORE course material and material assessable for exams will be contained within

1. Lecture slides
2. Lectures
3. Academic articles, news articles, videos, interviews or any other references mentioned explicitly in lectures
4. Homework Questions
5. Classes

Additional complimentary material is found in the corresponding University of London course study guide. Note that this is NOT the core material for the course, but COMPLIMENTARY to the core course material.

Optional Reading:

1. Monetary Economics by M.K. Lewis and P.D. Mizen, New York: Oxford University Press, 2000.
2. Money, Information and Uncertainty by C.A.E. Goodhart, London: Macmillan, 1989.
3. International Economics: Theory and Policy by P.R. Krugman and M. Obstfeld, London: Addison Wesley, 2003.
4. Modern Money and Banking by Miller R. and van Hoose D., London, 1993.
5. The Economics of Banking and Financial Markets by Mishkin, F., Boston, 2003.

Additional internet resources which may be helpful:

1. <http://econ.lse.ac.uk/courses/ec321>
2. http://wps.aw.com/aw_mishkin_econmbfm_8
3. http://wps.aw.com/aw_krgmnobstf_interecon_7
4. <http://www.imf.org>
5. <http://www.bis.org>

Course plan

1. The Nature of Money Defining money by its functions. Advantages of monetary economy over the barter economy. Types of money.
2. Demand for Money from First Principles. The Demand for Money will be derived from first principles for different economic environments.
3. Demand for Money Quantity theory of demand for money. Keynes' speculative demand for money. Transactionbased theories of money demand. Baumol-Tobin model and the Tobin's model of portfolio selection. Empirical evidence.
4. 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.
5. Monetary Policy in Practice Examination of how central banks are organised and how monetary policy is enacted in practice.
6. Classical Theory of Money I The classical dichotomy and monetary neutrality. Money in general equilibrium. Walras's law and the Patinkin's critique. The Real-Balance Effect.
7. Classical Theory of Money II Formal General Equilibrium modelling of a monetary economy through cash-in
8. Stylized Facts. Reading
9. Dynamics: 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.
10. Classical Theory of Money III Formal General Equilibrium modelling of a monetary economy through cash-in-advance. Focus on policy.

11. Classical Theory of Money IV Non-neutrality of money in a classical world. The role of frictions such as information (Lucas Islands "misperceptions" model).
12. Dynamics: Real Business Cycle Model Neo-Classical policy in practice.
13. Dynamics: Real Business Cycle Model Neo-Classical policy in practice.
14. Keynesian Model.
15. Keynesian models with money supply as a policy instrument.
16. Foundations of New-Keynesian Model
17. New-Keynesian Model I
18. New-Keynesian Model II
19. New-Keynesian Model
20. New-Keynesian Model in Practice
21. Time inconsistency in monetary policy
22. Barro-Gordon model
23. Uncertainties in monetary policy design
24. Multiplicative uncertainty
25. Term structure of interest rates

Special Equipment and Software Support

Laptop, projector, Internet connection

MS Word, MS Excel