ECON844

Monetary and Financial Policies

S2 Evening 2014

Economics

Contents

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General Information

Unit convenor and teaching staff
Unit Convenor
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E4A 432
TBA in the first lecture

Credit points
4

Prerequisites
ECON633 or admission to MActPrac or MCom or MEc or MIntBus prior to 2011

Corequisites

Co-badged status

Unit description
This unit examines a number of issues in monetary theory and policy. We begin with a refresher survey of the workhorse models in macroeconomics – ISLM, ASAD – and develop these for intertemporal modelling. Issues in monetary and fiscal policy design are then discussed, particularly in regard to the global financial crisis of 2008–2009. We study 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 are simulated in class to help understand how they respond to shocks like the global financial crisis.

Important Academic Dates

Information about important academic dates including deadlines for withdrawing from units are available at https://www.mq.edu.au/study/calendar-of-dates

Learning Outcomes

On successful completion of this unit, you will be able to:

Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.

Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.

Construct a framework for understanding modern dynamic stochastic general equilibrium models.

General Assessment Information

Missed mid-semester test and final exam will be covered by only one supplementary assessment upon a successful special consideration application; this could include an oral task. No extensions will be granted to essay and quiz. Students who have not submitted the essay prior to the deadline will be awarded a mark of 0 for the task, except for cases in which an application for special consideration is made and approved.

Assessment Tasks

Name	Weighting	Due
1. Online quiz	10%	28 August (6pm)
2. Mid Semester Examination	30%	11 September (6pm)
3. Essay	20%	16 October (6pm)
4. Final Examination	40%	Exam period

1. Online quiz

Due: **28 August (6pm)**
Weighting: **10%**

This will become available on iLearn under "Quizzes" on 19 August at 1pm. It will have to be completed online by 23 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 for not completing the assessment task.

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.

On successful completion you will be able to:
- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

2. Mid Semester Examination

Due: **11 September (6pm)**
Weighting: **30%**

Two-hour exam on 11 September 2013, 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. Upon successful special consideration application, missed mid-session test will be covered by only one supplementary test, which could include an oral test.

On successful completion you will be able to:
- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.
- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

3. Essay

Due: **16 October (6pm)**
Weighting: **20%**

Choice **EITHER** of the following topics:

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.*

Format: 2000 words limit, 12 point, 1.5 line spaces, A4. Please note you will get zero for the essay if you do not hand-in before the due date.

On successful completion you will be able to:
- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.
- Establish and discuss the design and constraints of monetary and macroprudential

regulation policy; in normal times and during a crisis.

- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

4. Final Examination

Due: **Exam period**
Weighting: **40%**

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 unit. Questions will primarily come from the second-half of the course, but not exclusively.

Upon successful special consideration application, missed final exam will be covered by only one supplementary test. This supplementary test may include an oral test.

On successful completion you will be able to:

- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.
- Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.
- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

Delivery and Resources

Required and Recommended Texts and/or Materials

For the first part of the course, we will use selected chapters from:

Olivier Blanchard & Jeffrey Sheen Macroeconomics Pearson, 4th Australasian edition, 2013

The fourth edition has a lot of material that will be directly relevant to the unit – in particular on building the foundation of our models.

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

Michael Wickens Macroeconomic Theory Princeton Press, 2008

Carl E Walsh, Monetary Theory & Policy MIT Press, 3rd ed , 2010

Other reference books include:

Jordi Gali, Monetary Policy, Inflation and the Business Cycle, 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

Carmen M. Reinhart & Kenneth S. Rogoff This Time Is Different: Eight Centuries of Financial Folly , Princeton University Press, 2010

Unit Web Page

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.

Unit Schedule

Topic 1. *Quick refresher on ISLM, ASAD macroeconomic models; the role of expectations in financial markets, and for consumption and investment*

- Blanchard & Sheen 2013 Chapters 3-8, 14-17.
- Stevens, Glenn 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

Topic 2. *The macroeconomics of financial crises; systemic risk and macroprudential regulation*

- Blanchard & Sheen, 2013 Chapters 9
- Taylor, John (2009) "The financial crisis and the policy responses: an empirical analysis of what went wrong" www.nber.org/papers/w14631,
- Hall, Robert E. (2010). "Why Does the Economy Fall to Pieces after a Financial Crisis?" Journal of Economic Perspectives, 24(4): 3–20. www.aeaweb.org/issue.php?journal=JEP&volume=24&issue=4
- Curdia, V. and M. Woodford (2010) "The Central Bank Balance Sheet as an Instrument of Monetary Policy" ideas.repec.org/p/clu/wpaper/0910-16.html
- Woodford, Michael "Financial Intermediation and Macroeconomic Analysis." Journal of Economic Perspectives, 24(4): 21–44.
- 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
- Carmen Reinhart & Ken Rogoff (January 2010) NBER WP15639,
- Financial Stability Review (March 2012), RBA www.rba.gov.au/publications/fsr/2012/mar/pdf/031

2.pdf

- Borio, C. and P. Lowe (2002) "Asset Prices, Financial and Monetary Stability: Exploring the Nexus". BIS Working Papers, No. 114.

- Trichet, J.C. (2009) Systemic Risk. Clare Distinguished Lecture in Economics and Public Policy. University of Cambridge,

- www.ecb.int/press/key/date/2009/html/sp091210_1.en.html

- Nier, Erlend W., Jacek Osiński, Luis I. Jácome, and Pamela Madrid (2011) "Institutional Models for Macroprudential Policy" www.imf.org/external/pubs/ft/sdn/2011/sdn1118.pdf

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 2013, Chapters 22-25

- Walsh Chapters Ch 4.1-3 or Wickens Chapter 5 (5.1-5.5)

- Blanchard, Olivier, 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

- Cochrane, John (2011) "Understanding fiscal and monetary policy in the great recession: Some unpleasant fiscal arithmetic." *European Economic Review*, January 55, 2-30

- Stevens, Glenn (2011) "The role of finance" *The Economic Record*, March, pp. 1-11.

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

- Robert Lucas (2000) "Inflation and welfare." *Econometrica*, 68(2), 247-74.

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)

- Romer, David (2006) *Advanced Macroeconomics*, McGraw Hill, 3rd ed. Ch 4

- Rebelo, Sergio (2005) "Real business cycle models: Past, present and future" *Scandinavian Journal of Economics* 107 (2), 217–238.

- Christiano, Larry, Martin Eichenbaum & C.Evans (2005) "Nominal rigidities and the dynamic effects of a shock to monetary policy" *Journal of Political Economy*, 113 (1).

- Clarida, Richard, Jordi Gali, and Mark Gertler (1999) "The science of monetary policy: A new Keynesian perspective," *Journal of Economic Literature*, 37(4), 1661–1707.

- Jeffrey Sheen and Ben Wang (2012) "Optimal monetary policy design for an imperfect economy", Macquarie University draft.

Policies and Procedures

Macquarie University policies and procedures are accessible from Policy Central. Students should be aware of the following policies in particular with regard to Learning and Teaching:

Academic Honesty Policy http://mq.edu.au/policy/docs/academic_honesty/policy.html

Assessment Policy http://mq.edu.au/policy/docs/assessment/policy.html

Grading Policy http://mq.edu.au/policy/docs/grading/policy.html

Grade Appeal Policy http://mq.edu.au/policy/docs/gradeappeal/policy.html

Grievance Management Policy http://mq.edu.au/policy/docs/grievance_management/policy.html

Disruption to Studies Policy http://www.mq.edu.au/policy/docs/disruption_studies/policy.html *The Disruption to Studies Policy is effective from March 3 2014 and replaces the Special Consideration Policy.*

In addition, a number of other policies can be found in the Learning and Teaching Category of Policy Central.

Student Code of Conduct

Macquarie University students have a responsibility to be familiar with the Student Code of Conduct: https://students.mq.edu.au/support/student_conduct/

Student Support

Macquarie University provides a range of support services for students. For details, visit http://students.mq.edu.au/support/

Learning Skills

Learning Skills (mq.edu.au/learningskills) provides academic writing resources and study strategies to improve your marks and take control of your study.

- Workshops
- StudyWise
- Academic Integrity Module for Students

- Ask a Learning Adviser

Student Services and Support

Students with a disability are encouraged to contact the Disability Service who can provide appropriate help with any issues that arise during their studies.

Student Enquiries

For all student enquiries, visit Student Connect at ask.mq.edu.au

IT Help

For help with University computer systems and technology, visit http://informatics.mq.edu.au/help/.

When using the University's IT, you must adhere to the Acceptable Use Policy. The policy applies to all who connect to the MQ network including students.

Graduate Capabilities

PG - Discipline Knowledge and Skills

Our postgraduates will be able to demonstrate a significantly enhanced depth and breadth of knowledge, scholarly understanding, and specific subject content knowledge in their chosen fields.

This graduate capability is supported by:

Learning outcomes

- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.
- Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.
- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

Assessment tasks

- 1. Online quiz
- 2. Mid Semester Examination
- 3. Essay
- 4. Final Examination

PG - Critical, Analytical and Integrative Thinking

Our postgraduates will be capable of utilising and reflecting on prior knowledge and experience,

of applying higher level critical thinking skills, and of integrating and synthesising learning and knowledge from a range of sources and environments. A characteristic of this form of thinking is the generation of new, professionally oriented knowledge through personal or group-based critique of practice and theory.

This graduate capability is supported by:

Learning outcomes

- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.

- Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.

- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

Assessment tasks

- 1. Online quiz
- 2. Mid Semester Examination
- 3. Essay
- 4. Final Examination

PG - Research and Problem Solving Capability

Our postgraduates will be capable of systematic enquiry; able to use research skills to create new knowledge that can be applied to real world issues, or contribute to a field of study or practice to enhance society. They will be capable of creative questioning, problem finding and problem solving.

This graduate capability is supported by:

Learning outcomes

- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.

- Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.

- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

Assessment tasks

- 1. Online quiz

- 2. Mid Semester Examination
- 3. Essay
- 4. Final Examination

PG - Effective Communication

Our postgraduates will be able to communicate effectively and convey their views to different social, cultural, and professional audiences. They will be able to use a variety of technologically supported media to communicate with empathy using a range of written, spoken or visual formats.

This graduate capability is supported by:

Assessment task

- 3. Essay

PG - Capable of Professional and Personal Judgment and Initiative

Our postgraduates will demonstrate a high standard of discernment and common sense in their professional and personal judgment. They will have the ability to make informed choices and decisions that reflect both the nature of their professional work and their personal perspectives.

This graduate capability is supported by:

Learning outcomes

- Comprehend what drives the relationships between key macroeconomic indicators (e.g. inflation, growth, interest rates, stock market indices) that should be a part of every manager's information set.
- Establish and discuss the design and constraints of monetary and macroprudential regulation policy; in normal times and during a crisis.
- Construct a framework for understanding modern dynamic stochastic general equilibrium models.

Assessment task

- 3. Essay

Research and Practice

This unit gives you practice in applying research findings in your tutorials and assignment.