

UNIVERSITY OF WATERLOO

Department of Economics

Economics 404 - Fall 2012

Topics in Money and Finance

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Location: HH 336

Time: 14:30-15:50 TuTh

Office Hours: Wed 1:30-3:00 or by appointment

1 Course Objectives and Textbooks

This course will cover various topics on money, monetary economics, monetary policy, banking and financial intermediation. Topics such as vector autoregressions, why are prices rigid?, targeting regimes, liquidity traps, zero lower bound, rules versus discretion and banking and financial intermediation will be covered. Two thirds of the course will be devoted to the New Keynesian model and issues related to this framework. The rest of the course will cover topics related to banking and financial intermediation.

I will make copies of my lecture notes available on UW-LEARN. They are mostly based on the articles and book chapters included in the reading list. In addition to the lecture notes and book chapters, there are a number of required readings for this class. Most of the papers can be downloaded from the course web page or are either available online through JSTOR, from the author's or journal's website and from the Library. Please let me know if you cannot find a particular paper.

There are two textbooks which I will use for this course. However, I recommend buying only the first book on the list.

1. Walsh, Carl E., *Monetary Theory and Policy*, 3rd edition, Cambridge: MIT Press, 2009. [CW]
2. Woodford, Michael., *Interest & Prices* Princeton University Press, 2003. (MW)
3. McCallum, Bennet., *Monetary Economics: Theory and Policy* Macmillan Publishing McC]
4. Gary Gorton *Slapped by the Invisible Hand* Oxford University Press, 2010.
5. Useful websites: Bank of Canada, Federal Reserve System, Bank of England, especially the working papers, the NBER and CEPR.

2 Evaluation

- Paper proposal (5%). The paper proposal is due in class on Thursday October 11.
- Paper (25%). The paper will be due on November 29. The paper is expected to be an empirical exercise related to monetary economics.
- One midterm worth 30 percent of your marks. The midterm is scheduled on Thursday November 1, 2012.
- 4 assignments (40%).

3 Lecture Topics and References

3.1 Empirical Evidence on Money and Output and VAR

- CW, Chapter 1
- Symposium on the Monetary Transmission Mechanism (particularly papers by Mishkin, Bernanke and Gertler and Taylor) *Journal of Economic Perspectives*, 1995, vol. 9, issue 4: 3—10
- Blanchard, Olivier Jean. “Why Does Money Affect Output? A Survey?” in *Handbook of Monetary Economics Vol 2* Friedman, B.M and Frank H. Hann. (eds.), North-Holland.
- Lucas, Robert E. 1996 “Nobel Lecture: Monetary Neutrality,” *Journal of Political Economy*, Vol. 104, no 4.
- Cochrane, John H. 1998. “What Do the VARs Mean? Measuring the Output Effects of Monetary Policy,” *Journal of Monetary Economics* 41: 277—300.
- Bernanke, Ben S., and Ilian Mihov. 1995. “Measuring Monetary Policy,” NBER WP 5145.
- Faust, Jon. 1998. “The Robustness of Identified VAR Conclusions About Money,” *Carnegie-Rochester Conference Series on Public Policy* 49: 207—244

3.2 General Equilibrium Models of Money

3.2.1 Money in the Utility Function

- CW, Chapter 2
- Cooley, Thomas F., and Gary D. Hansen. 1995. “Money and the Business Cycle,” in Cooley, Thomas F. (ed.), *Frontiers of Business Cycle Research*, Princeton: Princeton University Press.

3.2.2 Cash-in Advance Models

- CW, Chapter 3, section 3.3 and 3.6
- Cooley, Thomas., and Gary Hansen. 1989. “The Inflation Tax in a Real Business Cycle Model,” *American Economic Review* 79: 733—748.

3.3 New Keynesian Models and Optimal Monetary Policy

- CW chapter 5, JG chapter 4.
- Clarida, R., J. Galí and M. Gertler. 1999. “The Science of Monetary-Policy: A New Keynesian Perspective.” *Journal of Economic Literature*.
- MW chapter 3

3.4 Monetary Policy Rules

- CW Chapter 10.
- MW Chapter 2, p 85—102.
- Kozicki, Sharon. 1999. “How Useful Are Taylor Rules for Monetary Policy?” Federal Reserve Bank of Kansas City Economic Review.
- Clarida, Richard, Jordi Gal, and Mark Gertler. 2000. “Monetary Policy Rules and Macroeconomic Stability: Evidence and Some Theory,” *Quarterly Journal of Economics* 115: 147—180.

3.5 Financial Frictions

- CW Chapter 7, section 7.3
- Brunnermeier, M.K, Eisenbach, T.M and Y. Sannikov. 2012. “Macroeconomics With Financial Frictions: a Survey,” NBER Working Paper 18102.
- Bernanke, Ben S., Mark Gertler, and Simon Gilchrist. 1999. “The Financial Accelerator in a Quantitative Business Cycle Framework,” in John B. Taylor and Michael Woodford (eds.), *Handbook of Macroeconomics*, Amsterdam: North-Holland and NBER Working Paper No 6455.
- Kiyotaki, N and J. Moore. 1997. “Credit Cycles,” *Journal of Political Economy* 105:2, 211-248.

3.6 Financial Intermediation and Banking

- Diamond, D. W and P.H Dybvig. 1983. “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy* 91:3, 401-419.
- Diamond, D.W. 2007. “Banks and Liquidity Creation: A Simple Exposition of the Diamond-Dybvig Model,” FRB Richmond Economic Quarterly. 93:2, 189-200.

3.7 The Recent Financial Crisis, Structured Finance and Credit Ratings

- Brunnermeier, M. 2009. “Deciphering the Liquidity and Credit Crunch 2007-2008,” *Journal of Economic Perspectives* 23:1, 77-100.
- Cecchetti, S. 2009. “Crisis and Responses: The Federal Reserve in the Early Stages of the Financial Crisis,” *Journal of Economic Perspectives* 23:1, 51-75.
- Coval, J.D., Jurek, J.W. and E. Stafford. 2009. “The Economics of Structured Finance,” *Journal of Economic Perspectives* 23:1, 3-25.
- Geanakoplos, G. 2009. “Leverage cycles,” NBER Macroeconomics Annual.

Policy on Missed Tests and Assignments: No make-up tests or assignments will be provided. Students who do not have a relevant medical certificate will receive a mark of zero on any missed test or assignment. For students who miss one or more tests and have a relevant medical certificate, or medical certificates, the weight of the missed tests will be automatically transferred to the final.

Policy on Remarking of Tests: If you feel that your midterm was not marked properly, you must advise the instructor within 10 days of the test being handed back to the students in class. Note that if you want your test re-graded, I will remark the entire test (your mark may go up or down as a result of this) **Note on avoidance of academic offences:** All students registered in

the courses of the Faculty of Arts are expected to know what constitutes an academic offence, to avoid committing academic offences, and to take responsibility for their academic actions. When the commission of an offence is established, disciplinary penalties will be imposed in accord with Policy #71 (Student Academic Discipline). For information on categories of offences and types of penalties, students are directed to consult the summary of Policy #71 which is supplied in the Undergraduate Calendar¹ If you need help in learning how to avoid offences such as plagiarism, cheating, and double submission, or if you need clarification of aspects of the discipline policy, ask your TA or course instructor for guidance. Other resources regarding the discipline policy are your academic advisor and the Undergraduate Associate Dean.

Students who believe that they have been wrongfully or unjustly penalized have the right to grieve; refer to Policy #70, Student Grievance, <http://www.adm.uwaterloo.ca/infosec/Policies/policy70.html>.

Note for students with disabilities: The Office for Persons with Disabilities (OPD), located in Needles Hall, Room 1132, collaborates with all academic departments to arrange appropriate accommodations for students with disabilities without compromising the academic integrity of the curriculum. If you require academic accommodations to lessen the impact of your disability, please register with the OPD at the beginning of each academic term.

¹Section 1 on the Web at http://www.adm.uwaterloo.ca/infoucal/UW/policy_71.html.