

***Global Monetary and Financial Stability Policy***

***Fall 2012***

***Professor Zvi Eckstein***

***FNCE 893/393***

September 5, 2012 to October 18, 2012

*Office hours:* SH-DH room 2336, Tuesday 4:00 – 6:00 pm, by appointment

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*Sections:* TR 9-10:20 JMHH 255; TR 10:30-1:50 JMHH 255;  
TR 1:30-2:50 JMHH 90

***Summary:*** This course aims to provide the future global manager the knowledge on policies set by central banks, regulators and governments to reach the goals of price and financial stability. The core of the course connects between the formal and actual goals that central banks follow and the related economic analysis on which the goals and the policies are set. We will explain the economic rationale for the policy prescriptions to reach the goals and how these are implemented using institutional framework in the US, the EU, Israel and other countries. In addition, we shall study the role of central banks and regulators in providing policies for financial stability and interaction between the current debt crisis in the Euro area and financial stability. The course will use data, current events and events of the 2007-2012 financial crisis as a basis for discussion and assignments that aim at understanding how and why the Federal Reserve of the US (the Fed) and the European Central Bank (ECB) set their policies and how that is related to academic research on these subjects.

***Requirements and grading:*** Final examinations (50% - passing grade is required); four assignments done by teams of 3-4 students (40%); active participation in class discussion (10%).

***References:*** Use one textbook as well as additional books, reports and analysis that were recently published on each of the topics.

***Main Text:***

Mishkin, Frederic, S., "*The Economics of Money, Banking and Financial Markets*", Pearson, 9<sup>th</sup> Edition, 2011.

### 1. *Introduction (Sept. 6)*

What is a financial crisis and why does it cause the Great Recession?

- Overview of monetary, financial and fiscal events since the summer of 2007: US and global
- Readings:
  - Mishkin, chapter 9; p. 268, 273-8, 304
  - Reinhart, Carmen, M., and Rogoff, Kenneth, S., "This Time is Different – Eight Centuries of Financial Folly", *Princeton University Press*, 2009, chapters 10, 13, 14.
- **Assignment 1:** Summary of monetary, financial stability and macroeconomic conditions for a country. Due September 13.

### 2. *Monetary Theory and Policy: Foundations (Sept. 11)*

- What is the optimal (target) inflation rate?

Reading:

- Mishkin, chapters 13, 14, 15, 19, 24.
- Fisher, Irving, "The Debt Deflation Theory of Great Depressions", *Econometrica*, Vol. 1, No. 4, 1933, pp. 337-357.
- Friedman, Milton, and Schwartz, Anna, "A Monetary History of the United States, 1867-1960", *Princeton University Press*, 1971.
- Lucas, Robert, E. Jr, "Inflation and Welfare", *Econometrica*, Vol. 68, No. 2 (Mar., 2000), pp. 247-274.
- Sargent, Thomas, S., "The End of the Four Big Inflations", in *Inflation: Causes and Effects*, Robert E. Hall (editor), University of Chicago Press, 1982.

### 3. *Monetary Policy: The Taylor rule (September. 13)*

How do CB's conduct monetary policy?

Reading:

- Mishkin, chapter 16.
- Taylor, John, "Discretion versus Policy Rules in Practice", in *Carnegie-Rochester Conference Series on Public Policy*, 39 (1993): 195-341.
- Taylor, John, B., "Housing and Monetary Policy", in: Proceedings from Policy Panel in Jackson Hall, 2007, pp. 463-476.
- Taylor, John, B., "Monetary Policy Rules Work and Discretion Doesn't: A Tale of Two Eras", *The Journal of Money, Credit and Banking Lecture*, 2012.
- Taylor, John, B., "The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong" Keynote Speech, 2008.
- Bernanke, Ben, S. "Monetary Policy and the Housing Bubble", Speech at the annual meeting of the American Economic Association, 2010, available at:

<http://www.federalreserve.gov/newsevents/speech/bernanke20100103a.htm?source=myrealestatemoney.com/RENEWS>

- Svensson, Lars E.O., “Inflation Targeting”, in Friedman, Benjamin M., and Michael Woodford, eds., **Handbook of Monetary Economics**, Volume 3a and 3b.
- **Assignment 2:** Was the Fed federal fund rate too low too long and was an important cause of the 2007/8 financial crisis? Due September 25.

#### 4. ***Flexible Inflation Targeting Policy: Model and Practice (September 18)***

How does the monetary transmission work?

Reading:

- Mishkin, chapters 20-23
- Gali, Jordi, and Gertler, Mark, “Macroeconomic Modeling for Monetary Policy Evaluation”, *The Journal of Economic Perspectives*, Vol. 21, No. 4, 2007.

#### 5. ***Unconventional Monetary and Financial Stability Policies (September 20)***

Can monetary policy be effective at the lower zero bound?

Reading:

- Bernanke, Ben, S., "The Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression", *American Economic Review*, Vol. 73, No. 3, 1983, pp. 257-276.
- Bernanke, Ben S., “At the Stamp Lecture”, London School of Economics, London, England, January 13, 2009; also Jackson Hole speech, August 21, 2009.
- Johannes Stroebel and John B. Taylor, “Estimated Impact of the Federal Reserve’s Mortgage-Backed Securities Purchase Program”, Stanford University, June 2012.

#### 6. ***September 25;10:30-11:50; room JMHH G60; Central Banks Watch in the Global Market: Guest lecture - Jason Cummins, chief US economist and head of research of Brevan Howard Inc.***

- **Section 1 and 3: Discussion of Assignment 2** – Was the Federal Fund rate too low in 2002-2005?
- **Assignment 3:** Zero Lower Bound on Interest Rate and Open Market Operations. Due October 2.

7. **September 27; 1:30-2:20; room JMHH 365;**  
**The Fed policy: Guest lecture** - Dr. Loretta J. Mester, Executive Vice President and Director of Research, Federal Reserve Bank of Philadelphia

- **Section 1 and 2: Discussion of Assignment 2** – Was the Federal Fund rate too low in 2002-2005?

8. **Small open economy: The case of Israel (October 2)**  
Can exchange rate intervention enhance monetary policy?

Reading:

- Mishkin, Chapters 17, 18.
- Jacob Braude, “Israel and the Global Crisis: Events, Policy and Lessons”, in *The Great Recession: Lessons for Central Bankers*, by J. Braude, Z. Eckstein, K. Flug and S. Fischer (ed.), MIT Press, 2012 (forthcoming).

9. **The European Debt Crisis (October 4, 9)**  
How does fiscal policy affect financial stability?

Reading:

- Reinhart, Carmen, M., and Rogoff, Kenneth, S., “A Decade of Debt”, NBER working paper no. 16827, February 2011.
- “The Merkel Memorandum”, The Economist, August 11, 2012
- **Assignment 4:** How do you explain recent ECB policies? Does it follow a Taylor Rule or only one goal of “price stability”? Due October 16.

10. **Lessons from the Great Recession (October 11, 16)**  
What have we learned so far?

Reading:

- Reinhart, Carmen, M., and Rogoff, Kenneth, S., “This Time is Different – Eight Centuries of Financial Folly”, Princeton University Press, 2009, chapters 10, 13, 14.
- Stanley Fischer, “Introduction: Central Bank Lessons from the Global Crisis”, in *The Great Recession: Lessons for Central Bankers*, by J. Braude, Z. Eckstein, K. Flug and S. Fischer (ed.), MIT Press, 2012 (forthcoming).

**FINAL Examination: October 18; Time 6:00-8:00 pm; Rooms**

## I. **Teaching Assistants**

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| 1. Gill Segal,<br>Office: SH-DH:<br>TA for section 3        | email: <a href="mailto:segalg@wharton.upenn.edu">segalg@wharton.upenn.edu</a><br>Office hours: Thursday 4:30 p.m.        |
| 2. Ryan Peters,<br>Office: SH-DH: 2316<br>TA for section 1  | email: <a href="mailto:petersry@wharton.upenn.edu">petersry@wharton.upenn.edu</a><br>Office hours: Friday 3:00-4:00 p.m. |
| 3. Ram Yamarthy,<br>Office: SH-DH: 2316<br>TA for section 2 | email: <a href="mailto:yamarthy@wharton.upenn.edu">yamarthy@wharton.upenn.edu</a><br>Office hours:                       |