

Global Monetary and Financial Stability Policy

Fall 2013

Professor Zvi Eckstein

FNCE 893/393

August 29, 2013 to October 15, 2013

Office hours: SH-DH room 2336, Tuesday 4:30 – 6:00 pm, by appointment

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

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 price stability and financial stability and their interaction with the debt crisis in the Euro area. The course will use data, events and analysis prior and following the 2007-2009 financial crisis as a basis for discussion and assignments. The shall focus on understanding how the Federal Reserve of the US (the Fed) and the European Central Bank (ECB) to set their policies and how that is related to academic research.

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. These are required for the assignments and as additional references to class discussion.

Main Text:

Mishkin, Frederic, S., "*The Economics of Money, Banking and Financial Markets*", Pearson, 9th or 10th Editions, 2011 or 2013.

1. *Introduction (August 29)*

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; 9th Ed. p. 268, 273-8, 304. 10th Ed.
- 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 5.

2. *Monetary Theory and Policy: Foundations (Sept. 3-5)*

- What is the optimal (target) inflation rate? Why 2%?

Reading:

- Mishkin, 9th Ed. Chapters: 13, 14, 15, 19, 24; 10th Ed. Chapters:
- 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.
- FOMC, "Statement on Longer-Run Goals and Monetary Policy Strategy", January 29, 2013.

3. *Monetary Policy: The Taylor rule (September. 10-12)*

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., "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 17.

4. *Flexible Inflation Targeting Policy: Model and Practice* (September 17)

How does the monetary transmission work?

- Discussion of Assignment 2: Taylor vs. Bernanke

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 19)

Can monetary policy be effective at the zero lower bound?

What is the US exit policy?

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 Stroebe and John B. Taylor, “Estimated Impact of the Federal Reserve’s Mortgage-Backed Securities Purchase Program”, Stanford University, June 2012.

- **Assignment 3:** Zero Lower Bound on Interest Rate and Open Market Operations. Due September 26.

6. ***Small open economy: The case of Israel (September 26)***

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).

7. ***The European Debt Crisis (October 1 - 3)***

How does fiscal and monetary policy affect financial stability?

Reading:

- Reinhart, Carmen, M., and Rogoff, Kenneth, S., “Debt Overhang: Past and Present”, NBER working paper no. 18015, April 2012.
- Mario Draghi, Speech on July 26, 2012, “Whatever it takes”.
- “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 3.

8. ***Lessons from the Great Recession(October 4 – extra class)***

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 17.
- 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).

9. ***Guest Lecture (October 8)***

Central Banks Watch in the Global Market: Guest lecture – Dr. Jason Cummins, chief US economist and head of research of Brevan Howard Inc.

FINAL Examination: October 15; Time 6:00-8:00 pm; Rooms SH-DH 211 and 213

I. **Teaching Assistants**

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| 1. Gill Segal,
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| 2. Ryan Peters,
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