

Global Monetary and Financial Stability Policy

Fall 2014

Professor Zvi Eckstein

FNCE 893/393

August 28, 2014 to October 17, 2014

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

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Sections: TR 9-10:20; TR 10:30-1:50; TR 1:30-2:50 – JMHH F92

Summary: This course aims to provide the future global manager and financial analyst 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 and academic research that led to the policy prescriptions to reach the goals and how these are implemented using institutional framework. We use data, events and analysis prior and following the 2007-2012 financial crisis as a basis for discussion and assignments. The course shall focus on understanding how the Federal Reserve of the US (the Fed), The Bank of Israel (BOI) and the European Central Bank (ECB) 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: We refer to one textbook, papers, books, reports, lectures, news items and analysis that were recently published on each of the topics. These are *references* that are supportive information but ***are not required*** to follow. For the assignments we provide necessary readings.

Main reference Text:

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

1. *Introduction (August 28)*

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

Additional suggested readings:

- Mishkin, chapter 9; 9th Ed. p. 268, 273-8, 304. 10th Ed. Chapter 9.
- 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 policy framework for a country. Due September 4.

2. *Monetary Theory and Policy: Foundations (Sept. 2-4)*

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

Reading:

- FOMC, "Statement on Longer-Run Goals and Monetary Policy Strategy", January 29, 2013.

Additional suggested references:

- Mishkin, 9th & 10th Ed. Chapters: 13, 14, 15, 19.
- 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. 9-11)*

How do CB's conduct monetary policy?

Reading:

- 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>
- Taylor, John, B., "The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong" Keynote Speech, 2008.

- 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.

Additional suggested references:

- Mishkin, 9th and 10th Ed. Chapter 16, 23, 24.
- Taylor, John, “Discretion versus Policy Rules in Practice”, in *Carnegie-Rochester Conference Series on Public Policy*, 39 (1993): 195-341.
- 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 16.

4. *Unconventional Monetary and Financial Stability Policies (September 16-18)*

Can monetary policy be effective at the zero lower bound?

What is the US exit policy?

- September 16 Discussion of Assignment 2: Taylor vs. Bernanke

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

5. *Flexible Inflation Targeting Policy: Model and Practice (September 23)*

How does the monetary transmission work?

Additional suggested references:

- Mishkin, 9th Ed. Chapters 20-23; 10th Ed. Ch. 20, 22, 25.
- Gali, Jordi, and Gertler, Mark, “Macroeconomic Modeling for Monetary Policy Evaluation”, *The Journal of Economic Perspectives*, Vol. 21, No. 4, 2007.

September 25 – Jewish New Year - no class

6. *Small open economy: The case of Israel (Sept. 30- October 2)*

Can exchange rate intervention enhance monetary policy?

Reading:

- 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**, 2013.

Additional suggested references:

- Mishkin, 9th and 10th Ed. Chapters 17, 18.
- **Assignment 4:** Does the Bank of Israel intervention in Foreign Exchange market is economically justified? Due October 2.

7. *The European Debt Crisis (October 6)*

How does fiscal and monetary policy affect financial stability?

Reading:

- Mario Draghi, Speech on July 26, 2012, “Whatever it takes”.
- “The Merkel Memorandum” , *The Economist*, August 11, 2012

Additional suggested references:

- Reinhart, Carmen, M., and Rogoff, Kenneth, S., “Debt Overhang: Past and Present”, NBER working paper no. 18015, April 2012.
- **Optional Assignment 5:** 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 14)*

What have we learned from the Great Recession so far?

Additional suggested references:

- 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).

