

Global Monetary and Financial Stability Policy

Fall 2015

Professor Zvi Eckstein

FNCE 893/393

August 27, 2015 to October 13, 2015

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

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Class location: TR 9-10:20, JMHH F60; TR 10:30-11:50, JMHH F60; TR 1:30-2:50 – JMHH F55

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 as well as support of growth and employment. 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 European Central Bank (ECB), Israel and remarks on other countries. We use data, current events and events of the 2007-2012 financial crisis as a basis for discussion and assignments. All these are aimed understanding how and why 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 on these issues.

Requirements and grading: Final examinations (60% - passing grade is required); three out of four assignments done by teams of 3-4 students (30%); 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. Class 1: The financial crisis and monetary policy: an Introduction (August 27)

Suggested readings: Mishkin, chapter 9; 9th Ed. p. 268, 273-8, 304. 10th Ed. Chapter 9.

2. Class 2: Monetary Theory and Policy: Foundations (Sept. 1-3)

- What is the optimal (target) inflation rate?

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.
- 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.
- **Assignment 1:** Was the Fed federal fund rate too low too long and was it an important cause of the 2007/8 financial crisis? Readings are in the Assignment. Due date September 10.

3. Class 3: Monetary Policy: The Taylor rule (September. 8-10)

- How do CB’s conduct monetary policy?
- Sept. 10: discussion and presentations of assignment 1

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.
- Ben S. Bernanke (April 28, 2015), "The Taylor Rule: A benchmark for monetary policy?", Brookings. <http://www.brookings.edu/blogs/ben-bernanke/posts/2015/04/28-taylor-rule-monetary-policy>

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:** Zero Lower Bound on Interest Rate and Open Market Operations - what is the exit policy? Due Sept. 22.

4. Class 4: Flexible Inflation Targeting Policy: Model and Practice (September 15)

Suggested readings:

- 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.

5. Class 5: Unconventional Monetary and Financial Stability Policies (September 28)

- 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.
- **Discussion of assignment 2 and the FOMC decision of 9/17**
- **Assignment 3:** Why does the Bank of Israel intervene in the forex market and whether it is consistent with the Bank's objectives? Due September 29.

6. Class 6: Small open economy: The case of Israel (Sept. 22)

Can exchange rate intervention enhance monetary policy effectiveness?

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.

September 29: Discussion of assignment 3 and BOI decisions.

**7. Guest Lecture: Dr. David Woo, Managing Director, Head of Global Interest Rates & Currencies Research Bank of America, Merrill Lynch
Global Monetary Policies (September 24): 10:30 – 12:00 Room
??? JMHH**

8. Class 7: The European Debt Crisis and ECB monetary policy (Sept. 29-October 1)

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.
- **Assignment 4:** How do you explain recent ECB policies? Does it follow a Taylor Rule or only one goal of “price stability”? Due October 6.

9. ***Lessons from the Great Recession?(October 6)***

What have we learned from the Great Recession so far?

Additional suggested references:

- 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).
- **Discussion of Assignment 4: what is the ECB policy regarding the Greek crisis?**

FINAL Examination: October 13; Time 6:00-8:00 PM; JMHH 360, 345, 340

Teaching Assistants

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