

Global Monetary and Financial Stability Policy

Fall 2016

Professor Zvi Eckstein

FNCE 893/393

August 30, 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: FNCE 393 JMHH F60, 9:00-10:20; FNCE 893 JMHH F60, 10:30-11:50; FNCE 893 JMHH F55, 1:30-2:50

Summary: This course aims to provide the methods and knowledge on how central banks and governments think and implement policies 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 legal and actual goals that central banks follow and the related economic analysis on which these goals and policies are set. We explain the economic rationale for the policy prescriptions to reach the goals and how these are actually implemented by the Federal Reserve Bank (Fed) in the US, the European Central Bank (ECB), Bank of Israel (BOI) and some remarks on other countries. We use data, current events and events of the 2007-2013 financial crisis as the basis for discussion and assignments. All these are aimed understanding how and why the Fed, the ECB and the BOI set their policies. For each we shall simulate in class current decisions based on assignments related to past policies and the theory presented in class.

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 or **Business School 4th Edition.**

Recommendation: Ben Bernanke, *The Courage to Act: A Memoir of a Crisis and Its Aftermath*, W.W. Norton and co., 2015.

1. *Class 1: The financial crisis and monetary policy: an Introduction (August 30)*

Suggested readings: Mishkin, chapter 9; 9th Ed. p. 268, 273-8, 304. 10th Ed. Chapter 9; BC 4th Ed – Chapter 12.

2. *Class 2: Monetary Theory and Policy: Foundations (Sept. 1-6)*

- What is the optimal (target) inflation rate?
 - Reading: FOMC, “Statement on Longer-Run Goals and Monetary Policy Strategy”, January 29, 2013.

Additional suggested references:

1. Mishkin, 9th & 10th Ed. Chapters: 13, 14, 15, 19; BS 4th Ed- ch.3, Ch. 19, Ch. 22, Ch. 23.
 2. Lucas, Robert, E. Jr, “Inflation and Welfare”, *Econometrica*, Vol. 68, No. 2 (Mar., 2000), pp. 247-274.
 3. 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 13.

3. *Class 3: Monetary Policy: The Taylor rule (September. 6-8)*

- How do CB’s conduct monetary policy?
- Sept. 13: discussion and presentations of Assignment 1
- Reading:
 1. 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>.
 2. Taylor, John, B., “The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong” Keynote Speech, 2008.
 3. 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.
 4. 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:

1. Mishkin, 9th and 10th Ed. Chapter 16, 23, 24; BS 4th Ed. Ch. 18-19, Ch.25.

2. Taylor, John, "Discretion versus Policy Rules in Practice", in *Carnegie-Rochester Conference Series on Public Policy*, 39 (1993): 195-341.
 3. Svensson, Lars E.O., "Inflation Targeting", in Friedman, Benjamin M., and Michael Woodford, eds., **Handbook of Monetary Economics**, Volume 3a and 3b.
- **Assignment 2:** From the QE to normality: what is the path of Fed policy rate? Due Sept. 20.

4. Class 4: Flexible Inflation Targeting Policy: Model and Practice (September 13, 15)

- What are the transmission mechanisms of monetary policy in closed and open economy?

Suggested readings:

1. Mishkin, 9th Ed. Chapters 20-23; 10th Ed. Ch. 20, 22, 25. BS 4th Ed. Ch. 23-24 and Web Ch.1-5.
2. Gali, Jordi, and Gertler, Mark, "Macroeconomic Modeling for Monetary Policy Evaluation", *The Journal of Economic Perspectives*, Vol. 21, No. 4, 2007.

- Sept. 13: discussion and presentations of Assignment 1

5. Class 5: Unconventional Monetary and Financial Stability Policies (September 15, 20, 22)

- Can monetary policy be effective at the zero lower bound? What is the optimal path to "normality"?
- Suggested Reading:
 1. 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.
 2. Bernanke, Ben S., "At the Stamp Lecture", London School of Economics, London, England, January 13, 2009; also Jackson Hole speech, August 21, 2009.
 3. On Secular Stagnation and Fed policy: Read blogs by Larry Summers; Ben Bernanke and Bradford Delong.
 4. Mishkin, BS 4th Ed. Ch. 6, Ch. 17 p. 403-408 and Web Appendices.
- **September 20: Discussion of the FOMC decision of 9/21 and Assignment 2.**
- **Assignment 3:** The ECB monetary policy under Mario Draghi: Does it follow a Taylor Rule or only one goal of "price stability"? What is the impact of negative deposit rate and the ECB QE? Due September 27.

6. Class 6: The European Debt Crisis and ECB monetary policy (September 22, 27)

- How does fiscal and monetary policy affect financial stability?
- Reading:
- Mario Draghi, Speech on July 26, 2012, “Whatever it takes”.

Additional suggested references:

- Reinhart, Carmen, M., and Rogoff, Kenneth, S., “Debt Overhang: Past and Present”, NBER working paper no. 18015, April 2012.
- Carlo Altavilla, Giacomo Carboni, and Roberto Motto, "Asset purchase programmes and financial markets: lessons from the euro area", ECB, November 2015.
- **September 27:** Discussion of the next ECB monetary policy decision of 8/9 expected decision 20q10 and Assignment 3.
- **Assignment 4:** Why does the Bank of Israel intervene in the forex market and whether it is consistent with the Bank's objectives? Due at the examination.

7. Class 7: Small open economy: The case of Israel (September 29 and October 4)

- Exchange rate intervention and negative interest rate: Additional unconventional monetary policy tools?
- Suggested Reading:
Bank of Israel Monetary Policy Reports and Interest Rate Decisions at <http://www.bankisrael.gov.il/en/Pages/Default.aspx>

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; BS 4th Ed. Ch. 20-21.
- **October 4: Discussion of the BOI monetary policy framework and negative rates of the Swiss and Sweden central banks.**

8. Guest Lecture: Dr. David Woo, Managing Director, Head of Global Interest Rates & Currencies Research, Bank of America-Merrill Lynch Global Monetary Policies (October 11) at 10:30 class.

