



Department of Economics and Finance

ECON*4760
Topics in Monetary Economics
Winter 2014



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Office Hours: Mondays and Wednesdays, 1:00pm-2:20pm and by appointment

It is your responsibility as a student to be aware of and to abide by the University's policies regarding academic misconduct, e-mail communication, maintaining copies of out of class assignments, what to do when you cannot meet a course requirement and the drop date for this semester. To better understand these policies, visit:

https://dev.web.uoguelph.ca/economics_d7/important-notice-about-students-responsibilities-and-university-policies

COURSE OUTLINE

Textbooks:

The *required* textbook for this course is:

Modeling Monetary Economies

Bruce Champ, Scott Freeman and Joseph Haslag

Cambridge University Press, 3rd edition, 2011

Champ, Freeman and Haslag (2011) is reserved at the university library for your access.

Course Objectives:

In this course we study money and banking through constructing a series of formal economic models. It consists of two parts. Part one explores the functions of money and the cost of inflation using the OLG models. In Part two, banking, including both private banking and central banking, is studied. We examine the role of banks played in the economy and why banks are prone to bank runs. This study will help students understand financial crises. In addition, we study how monetary policy conducted by the central bank will affect the economy. Students are required to write a Canadian key policy rate forecast report based on this part.

Students are expected to develop a thorough understanding of important issues about money and banking, such as the role of money and banks in the economy, the cost of inflation, the origin and consequence of financial crises, how central banks conduct monetary policy, and how monetary policy affects the economy.

Course Requirements:

The final mark will be determined by a weighted average of scores on two assignments, a Canadian key policy rate forecast report, a midterm exam, and a final exam. Detailed instructions on the forecast report are given on page 4. The dates and relative weights on these requirements are as follows:

	Date	Weights
Assignment 1	Due on Feb 10, 2014 in class	5%
Midterm Exam	Feb 12, 2014 in class	20%
Assignment 2	Due on March 19, 2014 in class	5%
Key Policy Rate Forecast Report	Due on April 2, 2014 in class	30%
Final Exam	TBA	40%

Course Outline:

Part One: Money

1. A Simple Model of Money

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 1.

2. Inflation

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 3.

3. Price Surprises

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 5.

Part Two: Banking

1. Capital

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 6.

2. Liquidity and Financial Intermediation

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 7.

3. Central Banking and the Money Supply

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 8.

4. Money Stock Fluctuations

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 9.

5. Bank Risk

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 12.

6. Liquidity Risk and Bank Panics

Modeling Monetary Economies, Champ, Freeman, and Haslag, Chapter 13.

In keeping with the University's Learning Outcomes, the Department of Economics and Finance Learning outcomes (skills and knowledge competencies) for this course are:

Skills:

1. **Written Communication:** Students are required to write a Bank of Canada policy rate forecast report. In this report, students are asked to forecast the policy rate decision of the Bank of Canada on April 17th, 2013, and to explain this forecast based on their understanding about the Bank of Canada's monetary policy target, Canadian economic outlook, and the mechanism through which monetary policy affects the economy.
2. **Numerical and Analytical Problem Solving:** Students are required to study a series of economic models that are essentially math problems. Students are required to learn how to solve the model, derive the solutions, and illustrate the solutions in graphs. This will be assessed in two assignments, midterm and final exams.
3. **Problem Solving in a Real World Context:** The forecast report asks students to evaluate Canadian economic outlook and applies the course materials about monetary policy to the Bank of Canada's monetary policy decision.

Knowledge:

1. **Economic modeling:** Students will learn Overlapping Generations Models with money, the inflation bias model under discretionary monetary policy, and the bank run models. Students are required to understand the fundamental issues in money and banking, such as the role of money and banks in the economy, the cost of inflation, and bank runs, revealed by these models.
2. **Understanding of Specific Markets:** Students will understand how the money market works.
3. **Historical and Global Context:** We will introduce the development of monetary policy over time. We will also compare monetary policy in different countries.
4. **Economic Policy and Regulations:** We will examine monetary policy and compare it with fiscal policy. Regulations to banks to prevent bank runs are also studied.

Course Evaluation:

You will be asked to complete an evaluation of this course at some time during the last two weeks of the semester. **The evaluation for this course will be done in class.** The Department of Economics policy regarding the conduct and use of these evaluations will be found at

<https://www.uoguelph.ca/economics/course-evaluation>

Instructions on the Key Policy Rate Forecast Report

This report aims to help you understand how the interest rate policy is determined at the Bank of Canada, and how the interest rate policy affects the Canadian economy.

Every year the Bank of Canada selects eight pre-set dates on which it announces its key policy rate – the overnight rate target. For 2014, they are January 22, March 5, April 16, June 4, July 16, September 3, October 22, and December 3, respectively. Market participants pay close attention to these announcements, because the decision on the overnight rate target will reveal the perspective of the Bank of Canada on the Canadian economy, and will greatly affect the Canadian economy and consequently Canadian asset prices.

You are required to write a report to forecast the Bank of Canada's decision on April 16, 2014, based on your understanding about the Bank of Canada's policy target, Canadian economic outlook, and the mechanism through which the overnight rate target works on the Canadian economy. This report should contain

1. Your forecast on the decision of the Bank of Canada on the overnight rate target on April 16, 2014.
2. Your explanations about your forecast, based on:
 - a. Your understanding about the objectives of the Bank of Canada. That is, the goals the Bank of Canada intend to achieve using the overnight rate target. Please visit http://www.bankofcanada.ca/en/monetary/monetary_main.html to find detailed information about this issue. We will also discuss the general objectives of central banks in class.
 - b. Your perspective about the Canadian economy, including its output growth, unemployment, and inflation pressure. You should form your perspective based on the latest statistics on related economic variables. You can find some useful information at <http://www.bankofcanada.ca/en/rates/index.html>.

- c. How the forecasted overnight rate target will help the Bank of Canada to achieve its objectives. In Part two of this course, we will introduce how monetary policy affects the real economy. You are required to apply the course materials in this part.

The Bank of Canada issues a Monetary Policy Report after it announces its key policy rate to explain its decision on the rate, based on its view on the Canadian economic outlook, four times a year. This report will be a good reference for your forecast report. The currently available ones are at http://www.bankofcanada.ca/en/mpr/mpr_previous.html.

The report should be double-spaced and 10 pages maximum.