

DEPARTMENT OF ECONOMICS AND FINANCE
College of Management and Economics
University of Guelph

ECON*6490 –Money and Banking

Fall 2012

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Office Hours: Mondays & Wednesdays, 2:30pm-3:30pm, 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:

<http://www.uoguelph.ca/economics/node/1115>

COURSE OUTLINE

Textbooks:

The *recommended* textbooks for this course are:

Monetary Theory and Policy

Carl E. Walsh

The MIT Press 2003

Modeling Monetary Economies

Bruce Champ, Scott Freeman, and Haslag

Cambridge University Press, 2011

Understanding Financial Crises

Franklin Allen and Douglas Gale,

Oxford University Press, 2007

The first two textbooks are reserved at the department library for your access. Note that the department library is closed from 12:00PM to 2:00PM.

Course Objectives:

This course studies 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, the MIU (money-in-utility) models, and the CIA (cash-in-advance) models. Monetary policies are also studied. Part two covers some fundamental issues in the banking theory with a focus on financial stability. First, we study the role of banks as the provider of liquidity and risk pooling. Second, we examine why banks are prone to bank runs. The Diamond and Dybvig (1983) model and its recent extensions will be introduced. This study will help you understand the recent financial crisis. Third, we study frictions in the banking market caused by imperfect information.

Students are expected to develop a thorough understanding of some important economic issues in monetary and banking theory, such as the role of money and banks in the economy, the cost of inflation, and the origin and consequence of financial crises.

Course Requirements:

The final mark will be determined by a weighted average of scores on assignments, a midterm, and a final exam. The weights will be:

Assignments	20%
Midterm Exam (Oct 24, 2012, in class)	30%
Final Exam (During final exam period, TBA)	50%

Course Outline:

Part One: Money and Monetary Policies

1. A Simple Model of Money

Readings:

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

2. Inflation

Readings:

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

3. Price Surprises

Readings:

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

Monetary Theory and Policy, Carl E. Walsh, Chapter 5

Lucas, R.E., JR., “Expectations and the Neutrality of Money”, *Journal of Economic Theory*, 4 (2), 1972, 103-124.

4. Money Stock Fluctuations

Readings:

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

Freeman, Scott and Gregory Huffman, 1991, “Inside Money, Output and Causality”, *International Economic Review*, 32 (August), 645-667.

5. A MIU Model

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 2

6. CIA Models

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 3

Svensson, L. E. O., 1985, “Money and Asset Prices in a Cash-in-Advance Economy”, *Journal of Political Economy*, 93 (5), 919-944.

Cooley, T. F. and G. D. Hansen, 1989, “The Inflation Tax in a Real Business Cycle Model”, *American Economic Review*, 79 (4), 733-748.

Cooley, T. F. and G. D. Hansen, 1991, “The Welfare Costs of Moderate Inflation”, *Journal of Money, Credit and Banking*, 23 (3), 483-503.

7. Discretionary Policy and Time Inconsistency

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 8

Barro, R.J. and D. B. Gordon, 1983, “A Positive Theory of Monetary Policy in a Neutral-Rate Model,” *Journal of Political Economy*, 91 (4), 589-610.

Barro, R.J. and D. B. Gordon, 1983, “Rules, Discretion, and Reputation in a Model of Monetary Policy,” *Journal of Monetary Economics*, 12 (1), 101-121.

Part Two: Banking

1. Banks as Liquidity Providers and Bank Runs

Readings:

Understanding Financial Crises, Allen and Gale, Chapter 3

Allen, Franklin, and Douglas Gale, 1998, Optimal Financial Crises, *Journal of Finance*, Vol. 53, 1245-1283.

Diamond, Douglas W., and Philip H. Dybvig, 1983, Bank Runs, Deposit Insurance, and Liquidity, *Journal of Political Economy*, 91(3), 401-419.

Morris, Stephen, and Hyun Song Shin, 2001, Rethinking Multiple Equilibria in Macroeconomic Modeling, *NBER Macroeconomics Annual 2000*, 139-161.

Goldstein, Itay, and Ady Pauzner, 2005, Demand Deposit Contracts and the Probability of Bank Runs, *Journal of Finance*, 60(3), 1293-1327.

Kindleberger, Charles, and Robert Aliber, 2005, Manias, Panics, and Crashes: A History of Financial Crises, John Wiley & Sons, New Jersey.

Markus Brunnermeier, 2009, Deciphering the 2007-09 Liquidity and Credit Crunch, *Journal of Economic Perspectives*, Vol. 23, 77-100.

2. Adverse Selection in Banking

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 7

Akerlof, George A., 1976, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics*, Vol. 84, 488-500.

Jaffee, Dwight M. and Thomas Russell, 1976, Imperfect Information, Uncertainty, and Credit Rationing, *The Quarterly Journal of Economics*, Vol. 90, 651-666.

3. Moral Hazard in Banking

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 7

Stiglitz, Joseph E. and Andrew Weiss, 1981, Credit Rationing in Markets with Imperfect Information, *American Economic Review*, Vol. 71, 393-410.

4. Monitoring Costs in Banking

Readings:

Monetary Theory and Policy, Carl E. Walsh, Chapter 7

Williamson, S. D., 1986, “Costly Monitoring, Financial Intermediation and Equilibrium Credit Rationing”, *Journal of Monetary Economics*, 18 (2), 159-179.

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

<http://www.uoguelph.ca/economics/academics/courses/course-evaluation>