

Syllabus Spring 2012

The financial system and central banks are often in the news as countries cope with economic problems and crises. This course is an MBA elective that examines financial institutions, instruments, markets, and practices from the perspectives of both financial and economic stability. Several broad questions will be addressed in the course:

- How is the financial system organized? What purposes does it serve?
- Why and how do countries regulate the financial sector?
- What do central banks do? How do they do it?
- How is monetary policy transmitted to the economy?

The course will involve a combination of lecture, discussion and case analysis.

Course Schedule. ECON-B30.2333.20 will meet on Mondays and Wednesdays between 10:30am and 11:50am in KMC 2-65.

Required textbook. Stephen G. Cecchetti and Kermit L. Schoenholtz, *Money, Banking and Financial Markets*, McGraw-Hill Irwin, 2010 (ISBN: 978-0073375908).

The materials in this book, combined with current events, will form the core of what is covered in class meetings. We will frequently begin classes by discussing current events. Your participation is strongly encouraged.

Other Course Materials. Course announcements and readings not found in the textbook will be posted on Blackboard. Powerpoint slides for the lectures will be distributed in class and posted on Blackboard. Students should keep informed about central bank policy developments around the world and may do so by becoming regular readers of the *Financial Times*, *The Wall Street Journal*, or *The Economist*. Here is a [link](#) for an academic subscription to *The Economist* (my faculty id is 6014).

Course Requirements and Grades. Students must *either*: (a) submit problem sets for grading (see description below) *or*; (b) submit a “group virtual presentation” (see description below) that will be graded. Typically, the problem sets or the group virtual presentation will account for 25% of the course grade. An in-class midterm exam will account for 30% of the course grade, and the final exam for the remaining 45%. Attendance and class participation (including contributions on the Discussion Board) also will contribute to the course grade in the case of outliers (good or bad).

There will be no make-up for the midterm, which is required of all students. If a student obtains prior approval from the professor to be excused from the midterm due to a serious illness or the equivalent, the weight on the final examination will be increased

accordingly. Please take careful note of the midterm and final exam dates, which are not subject to change. Consistent with Stern policies, no more than 35% of the students should expect to receive a course grade of A or A-.

Problem Sets. For students who opt to submit problem sets for grading, you must turn in via Blackboard any four of the five sets (see final page of this syllabus). If you submit all five problem sets, only the first four submissions will be graded. All problem sets are to be completed individually and represent your own work. Problem sets submitted after the deadline will *not* be accepted.

Group Virtual Presentation. Students wishing to pursue this option should form groups of four persons and inform the professor by email *before* class on February 7. The group should then propose a topic by email before class on February 14, but project work should begin only after the topic has been approved. Once a topic has been approved, group membership is not subject to change.

First-proposer groups will have first choice of topic. The subject should be a current issue affecting monetary policy or financial stability and be defined narrowly enough to fit a 20-minute “virtual presentation” including Powerpoint slides and a short write-up of five pages. Groups also may recommend an outside reading (of up to 10 pages) to accompany their presentation.

After submission, each presentation will be posted as a thread on the Blackboard Discussion Board, inviting response from the entire class. Presentations will be assessed on effort, organization, knowledge and analysis, creativity, and effective communication of a well-defined subject. All Powerpoint presentations and accompanying write-ups are due for submission on Wednesday, April 4. Thereafter, if there is time and interest, I may ask one or more groups if they wish – on a voluntary basis – to make their presentation on video or in class. All students in a group will receive the same grade for the project.

Honor Code. Naturally, the Stern [Honor Code](#) applies. Please aim at the highest standard of professional behavior. Lateness, cellphone use, private conversations, browsing the internet, checking your email, and any other behavior that disrupts the class will be considered inappropriate. Repeated violations of this standard will affect your grade.

Office Hours and Staff. I usually will be available on Mondays after class for one hour in my office (KMC 7-181). My email address is kermit.schoenholtz@stern.nyu.edu. Teaching fellow Robert Rosener’s email address is rr1400@nyu.edu. Please email either or both of us with questions or suggestions.

Proposed Course Schedule

Note: Readings are to be completed *before* the first class of the week.

January 30, February 1

Core Principles, Money and the Financial System
Term Structure and Information Content of Interest Rates

Questions:

Why is financial development related to economic development?
How and why are financial institutions evolving?

Readings: Chapters 2, 3 and 7 (pages 164-176 only)

February 6, 8

Economics of Financial Intermediation

Questions:

How do financial institutions earn profit?
What accounts for shifts between bank finance and other types of finance?
What makes financial institutions vulnerable?

Readings: Chapters 11 and 12

February 13, 15

Financial Industry Structure and Regulation (I)

Questions:

Why are there so many banks in the United States?
What is the lender of last resort?
Do we need the government safety net?
How is regulation structured in different countries?

Readings: Chapters 13 and 14

Problem Set #1 Due February 13 before class

February 20 (no class) President's Day Holiday

February 22, 27

Regulation (II)

Questions:

What is systemic risk and how can regulators address it?
What are the differences between micro-prudential and macro-prudential regulation?
How will the global financial crisis affect regulation going forward?

Readings: Hanson, Kashyap and Stein, “A Macroprudential Approach to Regulation,” (pages 3-20 and “A Financial Reform Report Card” on pages 23-25)
Admati, “What Jamie Dimon Won’t Tell You...”
Acharya et al. “A Bird’s Eye View of the Dodd-Frank Wall Street Reform and Consumer Protection Act”

Problem Set #2 Due Feb 27 before class

Feb 29. March 5

Case Study: The Crisis of 2007-09 and the Central Bank as Lender of Last Resort

What caused the crisis? Why was it so broad, deep and prolonged?
What role did the lender of last resort play?
Bear, Lehman and AIG
How to distinguish between illiquidity and insolvency?
What is the long-run impact of the Fed’s approach?

Reading: Bernanke, Statement before the Financial Crisis Inquiry Commission.

March 7

Midterm Exam (in class – up to 90 minutes)

March 12 (no class), 14 (no class) Spring Break

March 19, 21

Central Banks in the World Today

Questions:

What do central banks do? Do we need them?
How do monetary and fiscal policy differ?
How are the Fed and the ECB similar? How are they different?

Readings: Chapters 15 and 16

March 26

The Central Bank Balance Sheet and the Money-Supply Process

Questions:

How does an open-market operation work?

How does a foreign exchange intervention work?

Can the central bank control the quantity of money in the economy?

Readings: Chapter 17

March 28, April 2

Monetary Policy: Stabilizing the Domestic Economy

Questions:

Why do central banks usually choose to control interest rates?

What is inflation targeting? How does it work? How does it relate to the risk of deflation?

What are the arguments for and against targeting a monetary aggregate?

Readings: Chapter 18

Problem Set #3 Due April 2 before class

April 4

Money Growth, Money Demand and Monetary Policy

Questions:

When inflation is high, why is it usually higher than money growth?

What are the arguments for and against targeting a monetary aggregate?

What is the ECB's reference value for money growth? Does it make sense?

Readings: Chapter 20

Group Virtual Presentations Due April 4 (end of day)

April 9, 11

Exchange Rate Policy and the Central Bank

The Trilemma of Open-Economy Monetary Policy

Questions:

How are exchange rates and interest rates linked?

Why do some countries choose to fix their exchange rates?

How should we understand China's exchange rate regime?

Can a country have a fixed exchange rate and an independent monetary policy?

Readings: Chapter 19 plus Appendix to Chapter 10

April 16, 18

Output, Inflation and Monetary Policy

Questions:

What is the monetary policy reaction curve?

How do policy changes affect the economy?

What is the short-run aggregate supply curve and why is it upward-sloping?

Readings: Chapter 21

Problem Set #4 Due April 16 before class

April 23, 25

Output, Inflation and Monetary Policy (continued)

Monetary Policy Transmission Mechanism

Questions:

How does stabilization policy work?

What is the role of policy rules?

Why might there be a tradeoff between the volatilities of output and inflation?

Can monetary policy be effective at a zero short-term interest rate?

What are “quantitative easing” and “credit easing?”

How is monetary policy transmitted when the financial system is impaired?

Readings: Chapter 22, Chapter 23 (pages 609-617)

Problem Set #5 Due April 26 (end of day)

April 30, May 2

European Monetary Union: Crisis of the Euro Area

Questions:

What are sources of the crisis? What challenges does it pose?

What policies are available to address it?

What have policymakers done? Whither the euro area?

Readings: Makin, “The folly of currency pegs”
 Feldstein, “Italy can save itself and the euro”
 Cooley et al., “What Hamilton can teach the euro zone”

May 7

Review

May 9

Final Exam (11:15am-1:15pm)

January 6, 2012

Problem Sets

Note: Except where specifically noted, all problems are from the third edition of the textbook. All problem sets must be submitted via Blackboard by the specified date. With the exception of problem set #5, all are due *before* the start of class. No late submissions will be accepted.

- #1. (Due February 13): Chapter 2: Problems 4, 17, 19
Chapter 3: Problems 3, 11, 19, 20
Chapter 11: Problems 1, 10, 17
Chapter 12: Problems 11, 12, 18
Blackboard: Excel problem – Term Structure of Interest Rates
- #2. (Due February 27): Chapter 13: Problems 7, 12, 15
Chapter 14: Problems 6, 8, 10, 18, 20
Explain in one page (200 words): Why did the Fed bail out the creditors of Bear and AIG but not Lehman? If the Dodd-Frank rules had been in place, how would the policy response have changed? With what broader consequences?
- #3. (Due April 2): Chapter 15: Problems 2, 7, 14, 15
Chapter 16: Problems 2, 8, 11
Chapter 17: Problems 2, 7, 9, 11, 12, 16
- #4. (Due April 16): Chapter 18: Problems 2, 11, 12
Chapter 19: Problems 7, 14, 15, 16
Chapter 20: Problems 1, 2, 10
Write one paragraph: Which unconventional monetary policy is best suited to repairing a dysfunctional MBS market? Why?
Blackboard: Excel forecasting exercise – Estimating Money Demand
- #5. (Due April 26 end-day): Chapter 21: Problems: 4, 10, 13, 18, 19
Chapter 22: Problems 3, 8, 11, 12, 13, 16, 17