

**Economics 516: Monetary Theory - Summer 2020**  
**Prof. Claudio Paiva**

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**Course TA/Grader:** Sergio de Holanda Rocha - sdrocha2@illinois.edu

**Online delivery:** Zoom meetings, synchronous and asynchronous; please refer to the course detailed schedule.

**Zoom Office hours:** Please see the detailed course schedule (subject to change – Compass will be up to date)

**Course Description (Catalog)**

Micro- and macroeconomic theories of the supply of and demand for money; money substitutes and their significance; review of current empirical research; money in closed economy, macroeconomic, and static general equilibrium models; and analysis of inflation and unemployment.

Prerequisite: Consent of instructor. MSPE Graduate Student Standing.

**Course Objectives**

The purpose of this course is to introduce you to the major theoretical issues in monetary (and macro) economics that carry implications for policy decisions and policy assessment relating to interest rates, prices, output, and unemployment. Most of the course topics will be developed in the context of the historic evolution of ideas. This approach may not only provide more context, placing various theories within the broad and long debate between representatives of the Classic and Keynesian paradigms, but should also facilitate the understanding and importance of each individual contribution to the current body of knowledge that generally informs policy makers around the world.

**Grading**

The course grade will be determined by your performance on the following:

Homework Assignments: 30%	Mid-term: 30%	Final Exam: 40%
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Homework Assignments may be done in groups of 2 or 3 students. Exams must be done individually and returned via e-mail attachment before the deadline (90 min for the mid-term and 2 hours for the final).

The final exam is comprehensive and will take place on **Monday, June 15, 1 pm – 3 pm**

**Course Materials:**

- Recommended textbooks for background reading & lecture support (see separate, detailed reading list):
  - Macroeconomics, A. Abel, B. Bernanke, D. Croushore
  - Monetary Economics, M. Lewis and P. Mizen
  - Monetary Theory and Policy, C. Walsh
  - Monetary Economics, J. Handa
- Individual academic articles will be used, cited and/or posted throughout the course
- Lecture slides, notes, media articles for discussion, homework assignments and other supporting material will be posted on the Compass course page.
- I strongly recommend you to follow current events related to global financial markets, macro and monetary policies. Some exam and homework questions will be related to those events. Among interesting and reputable sites, I recommend <http://www.bloomberg.com> and <http://www.cnbc.com>

## **Communication and Other Issues.**

- Requests for re-graded exams must be handed in no later than one week after the exam is returned.
- Please use e-mail only for short and sporadic communication. Substantive questions about the material are best answered/discussed during live Zoom sessions and “office hours” (see schedule)
- If you would like to go further in depth regarding practical issues related to monetary and macro policies, I would be glad to discuss and share experience and material I have developed in the context of my work for the IMF. For instance, I would be happy to discuss the IMF’s assessment and recommendations for your home country as presented in recent reports available at <http://www.imf.org/en/Countries>
- If you have any problems with the course, please request a Zoom meeting as soon as possible

## **Course Content**

### **Part One: Introduction and Overview**

1. The nature of money
  - a. Basics
  - b. A brief history of money
  - c. Money supply and monetary aggregates
  - d. Functions of money ... and how they are lost – the case of Brazil
2. Monetary economics overview as an empirical relationship between money, output, and prices
  - a. Introduction of quantity equation as a simple framework for stylized empirical measurements
    - i. Velocity originally a technical issue
    - ii. Velocity evolved to being viewed as inverse money demand
  - b. Key question: money neutrality
    - i. Long-run
    - ii. Short-run
  - c. Stylized facts and empirical correlations in the quantity theory
  - d. Quick review: how the traditional Keynesian IS-LM, AD-AS-LRAS framework deals with neutrality
    - i. Short-run AS
    - ii. Long-run AS (LRAS)
3. The evolution of monetary theory schools of thought – an overview
  - a. The classic ideas
  - b. Keynes
  - c. The New Classical
    - i. Monetarism
    - ii. The Rational Expectations revolution
    - iii. Real Business Cycle Theory
  - d. The New Keynesians
    - i. “General Disequilibrium”
    - ii. Rational expectations without market clearing
    - iii. Rationalization of sticky prices and wages

### **Part Two: Monetary Theory**

4. The Classics
  - a. Walras, Say’s law, and the determination of relative prices
  - b. The quantity theory and the determination of the price level
  - c. The Classic Dichotomy
  - d. Transmission mechanism
    - i. Direct
    - ii. Indirect - Wicksell as a precursor to interest rate targeting mon policy

- e. Patinkin Critique and the Real-Balance Effect
- 5. Keynesian Inspiration
  - a. Rejecting (short-run) neutrality – evidence from Great Depression.
  - b. Motives for holding money
  - c. Money demand in Keynesian synthesis: LM curve; velocity revisited
  - d. The macroeconomics of wage and price rigidities
  - e. Keynesian Business Cycle Theory
  - f. The Phillips Curve
- 6. New Classical Inspiration
  - a. Micro-foundations of demand for money: CIA and MIU to complement Solow and Ramsey models
    - i. Neutrality and super-neutrality derived
    - ii. Seigniorage and inflation tax
    - iii. Welfare costs of inflation
    - iv. Necessary conditions for neutrality and super-neutrality
  - b. Friedman, monetarism, and the quantity theory revisited
  - c. Real Business Cycle Theory
  - d. Information asymmetry, Rational expectations, and Lucas Supply Curve
  - e. Phillips Curve revisited
- 7. Dynamic Stochastic General Equilibrium Models – an introduction
- 8. Additional Implications for Monetary Policy
  - a. Time inconsistency
  - b. Rules v. discretion
  - c. Taylor rule

### **Part Three: Open Economy and Fiscal Considerations**

- 9. IS-LM in open economy: Fixed v. Flexible ER
- 10. Monetary and Exchange Rate Arrangements
  - a. Inflation Targeting
  - b. Monetary and exchange rate-based stabilization plans
- 11. Some Unpleasant Monetarist Arithmetic – The Role of Expectations and Fiscal Sustainability
- 12. IMF Debt Sustainability Assessment Framework

### Tentative Course Schedule and Deadlines

Date		Live	Lecture Subject (by item number)		Assignment	Deadline
MAY	18	M	10:00 AM	Y	Course introduction and overview	
	18	M	1:00 PM	Y	1a, 1b, 1c, 1d	
	19	T	10:00 AM	N	2a, 2b, 2c	
	19	T	1:00 PM	Y	Q&A	PS #1 posted
	20	W	10:00 AM	N	2d	
	20	W	1:00 PM	Y	3a, 3b	
	21	Th	10:00 AM	N	3c	
	21	Th	1:00 PM	N	3d	PS #2 posted
	22	F	1:00 PM	Y	Office Hours Upon Request	PS #1 due
	25	M			Holiday	Holiday
	26	T	10:00 AM	N	4a, 4b	
	26	T	1:00 PM	N	4c, 4d	
	27	W	10:00 AM	Y	4d, 4e	
	27	W	1:00 PM	Y	5a, 5b	
	28	Th	10:00 AM	N	5c, 5d	
	28	Th	1:00 PM	Y	5e, 5f	PS #3 posted
	29	F	1:00 PM	Y	Office Hours Upon Request	PS #2 due
	1	M	10:00 AM	Y	Q&A + Exam Prep	
	1	M	1:00 PM	N	EXAM 1	
	2	T	10:00 AM	N	6a	
	2	T	1:00 PM	N	6a, 6b	PS #3 due
	3	W	10:00 AM	N	6c, 6d	PS #4 posted
	3	W	1:00 PM	Y	6d, 6e	
	4	Th	10:00 AM	N	7	
	4	Th	1:00 PM	Y	8a, 8b	
	5	F	1:00 PM	Y	Office Hours Upon Request	
	8	M	10:00 AM	N	8c	
	8	M	1:00 PM	Y	9	PS #4 due
	9	T	10:00 AM	N	10	
	9	T	1:00 PM	Y	10a	PS#5 posted
	10	W	10:00 AM	Y	10b	
	10	W	1:00 PM	N	10b	
	11	Th	10:00 AM	N	11	
	11	Th	1:00 PM	Y	12	
	12	F	1:00 PM	Y	Office Hours Upon Request	PS #5 due
	13	Sat	1:00 PM	N	FINAL EXAM	