

Economics 516: Monetary Theory - Summer 2018
Prof. Claudio Paiva

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Office hours: M/W 11:45 am –12:45 pm; and by appointment.

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.

Course Requirements and Evaluation Procedure.

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

Homework Assignments: 25% Mid-term: 30% Final Exam: 45%

The final exam is comprehensive and will take place on **Friday, August 3, 10:30 am -12:30 pm**

The following materials are allowed for use during the exam: graphing calculator, accounting calculator or four-function calculator. There are to be no books, papers other than the exam itself, smart phones, tablets, or other items that are capable of connecting to the internet. Students found to be using unapproved items are in violation of the Academic Integrity policy of the University and will be subject to disciplinary action.

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 course website: <http://compass2g.illinois.edu>
- 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, doubts about the material are best answered/discussed in class, during office hours, or special appointments, if needed.
- 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 come see me as soon as possible - don't fall behind!

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
12. IMF Debt Sustainability Assessment Framework

Tentative Course Schedule and Deadlines

	Day	Lecture Subject (by item num)	Assignment	Deadline
JUNE	11	Course introduction and overview		
	12	1a, 1b, 1c, 1d		
	13	2a, 2b, 2c		
	14	2d	Problem set (PS) #1 posted	
	18	3a, 3b		
	19	3c, 3d		
	20	4a, 4b, 4c		
	21	4d, 4e	PS #2 posted	PS #1 due
	25	5a, 5b, 5c		
	26	5c, 5d		
	27	5e, 5f		
	28	5f		PS #2 due
	JULY	2	PS #3 in-class activity	
3		Q&A		
4		HOLIDAY		
5		EXAM		
9		6a		
10		6a		
11		6b, 6c		
12		6c, 6d	PS #4 posted	
16		6d		
17		6e		
18		7		
19		8a, 8b		PS #4 due
23		8c		
24		9		
25		9; 10		
26		10a; 10b	PS#5 posted	
30	10b			
31	11			
AUGUST	1	12		
	2	Q&A		
	3	FINAL EXAM	10:30 am - 12:30 pm	PS #5 due