

Economics 817
Graduate Monetary Economics
Spring 2009
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Monetary theory is like a Japanese garden. –Milton Friedman

This course is about the links between money and output in the short run. Fundamentally, it is a course about some of the causes of business cycles, not about their cure. Thus, we will largely omit discussions of monetary policy.

Instead, we will cover the basics of time series econometrics so that you can understand the language of this literature; we will cover some classics of monetary history, so you can take part in the profession's conversation; and we will cover the basics of financial fragility in theory and practice, so that you can contribute to future research.

Most weeks, you will have homework assignments. In lieu of a final exam, you will write a *very* short academic paper suitable for publication in *Economics Letters* or a comparable research outlet.

Required Texts (available at GMU Bookstore)

Enders, (2004). *Applied Econometric Time Series*. Wiley (two editions: either is acceptable).

Friedman and Schwartz (1963). *A Monetary History of the United States: 1867-1960*. Princeton University Press.

Stigum and Crescenzi (2007). *Stigum's Money Market: Fourth Edition* (earlier editions are far out of date).

Background Reading

I strongly recommend having on hand a money and banking text (e.g., texts by Mishkin, Hubbard, Ball, Cecchetti) as well as an intermediate macro text (e.g., Mankiw, Hall/Taylor, Hall/Papell, or Barro for the very brave). These texts usually do a good job passing on the lore, the art, of monetary economics; intermediate texts also fill in many small gaps in intuition and history that are omitted in journal articles.

Course outline

Asterisk indicates required reading. There are many good articles and books that are omitted from this list; if you plan to become a monetary researcher, treat this as a mere starting point.

Unit 1: Elementary Models of Money

*Axel Leijonhufvud (1973). "Life among the Econ," *Economic Inquiry*.

Unit 2: Basics of Time Series

*Enders, chapter 1 (omit “Method of undetermined coefficients”)

*Enders, chapter 2 (all)

*Enders, chapter 4 (omit “Panel unit root tests”)

*Enders, chapter 5 (omit “Structural VARs” and “Examples of Structural Decompositions”)

Unit 3: Basics of Applied Macroeconometrics

Barro, (1978). “Unanticipated Money, Output, and the Price Level in the United States,” *Journal of Political Economy*.

**Barro, (1977). “Unanticipated Money Growth and Unemployment in the United States,” *American Economic Review*

**Christiano, Eichenbaum, Evans (1998). “Monetary policy shocks: What have we learned and to what end?” *Handbook of Macroeconomics* (Available online via GMU’s Elsevier subscription; the entire *Handbook* is well worth perusing).

Gordon, ed. (1986). *The American Business Cycle: Continuity and Change*, National Bureau of Economic Research (This edited volume is a classic of applied macroeconometrics).

*Hafer, Haslag, Jones (2007). “On money and output: Is money redundant?,” *Journal of Monetary Economics*.

Kashyap and Stein, “What do a million observations on banks say about the transmission of monetary policy?” *American Economic Review*.

*Romer and Romer (1989). “Does Monetary Policy Matter? A new test in the spirit of Friedman and Schwartz.” *NBER Macroeconomics Annual*.

*Taylor, “Staggered Price and Wage Setting in Macroeconomics,” NBER Working Paper, and PDF available on Taylor’s Stanford website.

Additional VAR readings recommended in Romer and Romer’s course:

http://emlab.berkeley.edu/users/webfac/cromer/e210c_f08/Reading9_3_08.pdf

Unit 4: Basics of U.S. Monetary History and the U.S. Money Market

History:

*Friedman and Schwartz, chapter 1, 7, 13, Appendices A and B (all)

*Friedman and Schwartz, chapter 8 (part 1 only)

Bordo, Erceg and Evans (2000). “Money, Sticky Wages and the Great Depression.” *American Economic Review*.

***Friedman (1968). "The role of monetary policy," *American Economic Review*.

Hamilton (1992) "Was the Deflation During the Great Depression Anticipated? Evidence from the Commodity Futures Market," *American Economic Review*.

*Hamilton, (1987). "Monetary Factors in the Great Depression," *Journal of Monetary Economics*.

Romer, (1993). "The Nation in Depression," *J. Econ Perspectives*.

Romer, (1992). "What ended the Great Depression?" *J. Econ History*.

The Money Market:

*Stigum/Crescenzi, chapters 1-3 (all)

*Stigum/Crescenzi, chapter 4 (omit "advanced topics")

*Stigum/Crescenzi, chapter 6 (omit "advanced topics")

*Stigum/Crescenzi, chapter 7 (through "the market today," page 230)

*Stigum/Crescenzi, chapter 8 (all)

*Stigum/Crescenzi, chapter 9 (all)

*Stigum/Crescenzi, chapter 10 (through "a dealer's book," page 430)

*Stigum/Crescenzi, chapters 12, 14, 22 (all)

Friedman, (1969). "The Optimum Quantity of Money," in *The Optimum Quantity of Money and Other Essays*, Aldine Publishing.

*Hamilton, "Measuring the Liquidity Effect," *American Economic Review*.

*Jones, (2006). "The liquidity effect across the short end of the term structure," *Applied Financial Economics Letters*.

Tsiang, (1969). "Notes on the optimum quantity of money," *Journal of Money, Credit, and Banking*.

Unit 5. Financial Fragility and Bubbles

Fragility:

*Bernanke, Gertler, and Gilchrist, (1999). "The Financial Accelerator in a Quantitative Business Cycle Framework," *Handbook of Macroeconomics*.

Bernanke (1983). "Nonmonetary Effects of the Financial Crisis in Propagation of the Great Depression," *American Economic Review*.

**Bernanke and Gertler, "Inside the black box: The credit channel of monetary transmission," NBER Working Paper and *Journal of Economic Perspectives*.

**Bernanke and Gertler, "Agency costs, collateral, and business fluctuations," a.k.a. "Agency costs, net worth, and business cycles," *AER* (Google Scholar has incorrect title)

Bordo and Schwartz (2000). "Measuring Real Economic Effects of Bailouts," *Carnegie Rochester Conference Series on Public Policy*. (now *Journal of Monetary Economics*)

Calomiris (1993). "Financial Factors in the Great Depression," *Journal of Economic Perspectives*.

Calomiris and Mason (1997). "Contagion and Bank Failures During the Great Depression: The June 1932 Chicago Banking Panic," *American Economic Review*.

Diamond, Douglas W., and Philip H. Dybvig (1983). "Bank Runs, Deposit Insurance, and Liquidity." *Journal of Political Economy*.

Diamond and Rajan (2001). "Liquidity Risk, Liquidity Creation, and Financial Fragility: A Theory of Banking" *Journal of Political Economy*.

*Fisher (1933). "A Debt-Deflation Theory of Depressions," *Econometrica*.

Freixas and Rochet, (2008) *Microeconomics of Banking*. MIT Press (available online via GMU Library Catalog).

Chapter 6

*Chapter 7

Holmstrom and Tirole, (1997). "Financial Intermediation, Loanable Funds, and The Real Sector" *Quarterly Journal of Economics*.

*Hubbard, (1998). "Capital market imperfections and investment," *Journal of Economic Literature*.

Kashyap, Stein, and Wilcox (1993). "Monetary Policy and Credit Conditions: Evidence from the Composition of External Finance." *American Economic Review*.

Kiyotaki and Moore, (1997) "Credit Cycles," *Journal of Political Economy*.

*Taylor and Williams (2009). "A Black Swan in the Money Market," *American Economic Journal: Macroeconomics*.

Walsh (2000). *Monetary Theory and Policy*. MIT Press (available online via GMU Library Catalog).

**Chapter 7

Chapter 9

Bubbles:

Allen and Gale, (2002) "Bubbles and Crises," *Economic Journal*.

*Camerer, (1989) "Bubbles and Fads in Asset Prices," *Journal of Economic Surveys*.

DeLong, Shleifer, Summers, Waldman (1990). "Positive Feedback Investment Strategies and Destabilizing Rational Speculation," *Journal of Finance*.

Garber, (1989). "Tulipmania," *Journal of Political Economy*.

Hamilton and Whiteman (1985) "The Observable Implications of Self-Fulfilling Expectations," *Journal of Monetary Economics*.

Kindleberger, (1989) *Manias, Panics, and Crashes: A History of Financial Crises*, esp. chapters 1-3.

*Postrel, (2008) "Pop Psychology:" *Atlantic Monthly*.

Rosser, (1997). "Speculations on nonlinear speculative bubbles," *Nonlinear dynamics, psychology, and life sciences*.

Shleifer , (2000). *Inefficient Markets: An introduction to behavioral finance*.

***Smith, Suchanek, Williams (1988). "Bubbles, Crashes, and Endogenous Expectations in Experimental Spot Asset Markets." *Econometrica*.

Note: I reserve the right to moderately amend the reading list in light of the voluminous research now pouring out regarding the ongoing financial crisis. Quite likely, this will only affect unit 4's section on the money market, and unit 5's section on financial fragility.

Software: You will need to have access to EViews for this course. It's a user-friendly time series package, used heavily in finance and macro forecasting settings. The slightly-crippled student version is \$32 per student if the class makes a bulk purchase. I expect us to use the package from Week 3 onward.

Hardware: If you have laptop computers, please load you laptop with EViews, and bring the laptop to class while we are covering the basics of time series econometrics.

Grading:

Homework:	50% of total
Class Participation:	10% of total
Short Article:	40% of total

Most weeks, you will have homework. Early in the semester, the homework assignments will consist of problem sets (some from Ender's end of chapter questions) as well as data analysis.

Later in the semester, you will be asked to write referee reports for articles, treating them as if they have been submitted to journals. Short (2 page) reaction pieces will also be assigned.

A draft of your final project—the short article—will be due a few weeks before the end of the semester. These will be distributed randomly to your classmates. One of your homework assignments will be writing a referee report of a draft written by one of your classmates.

Thorough homework instructions, final article instructions, and deadlines will be posted on Blackboard.

Students with Disabilities

I am happy to make all necessary accommodations for students with disabilities. University policy states that students who would like to request such accommodations should first contact the Office of Disability Services (993-2474, Sub I Room 222).