Economics 330
Money and Banking
(Fall 2006)

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Outline

- Administrative issues
- The current macro context
- Some basic concepts and definitions
Administrative Issues

• Course website: http://www.ssc.wisc.edu/~mchinn/web330_f06.html

• OH: MW 2:30-3:30, 7418 Soc Sci

• Textbook: Mishkin, Economics of Money, Banking and Financial Markets 8/e (7/e okay)

• Grading: 20% PS, 40% 2xMTs, 40% Final
Administrative Issues

• Dates:
  - MT1 on Wed. 10/11
  - MT2 on Wed. 11/8
  - Final on Fri. 12/22

• Make-ups: **None.** Points are re-allocated if you have a legitimate excuse. **No** late assignments accepted (have to be handed in)

• If you know you can’t make the final exam, **don’t** take the course.
Macro Context

• The slowdown and potential recession
• Housing price deflation
• Associated energy shocks
• Government budget deficit
• Current account and trade deficits
Annualized growth = \[\left(\frac{X(t)}{X(t-1)}\right)^4 - 1\] when data is quarterly
The Slowdown: Employment

Nonfarm payroll employment ('000s)

Civilian employment ('000s)
The Slowdown: Employment

Average growth = \[(\frac{X(t)}{X(t-1)})^{12} - 1\] when data is monthly.
The Slowdown: Hours

Aggregate Hours Worked [left scale]

Average Weekly Hours [right scale]
The Slowdown: Yield Curve

10 year-3 month spread

Sep. 5
-0.21%
The Slowdown: Housing

http://www.ofheo.gov/media/pdf/2q06hpi.pdf
Petroleum Prices

Real Oil Price WTI (CPI=1 '82-'84)

Nominal Oil Price WTI
Gasoline

Weekly U.S. Retail Gasoline Prices, Regular Grade

Source: Energy Information Administration

http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_home_page.html
Macro Implications: Framework

[Diagram of aggregate supply (AS) and aggregate demand (AD) curves showing intersection at point E, indicating equilibrium price level P* and output Y*]
Negative Supply Shock
Appendix: Definitions

Growth Rates and the Inflation Rate

Growth Rate = \( \frac{x_t - x_{t-1}}{x_{t-1}} \times 100 \)

GDP Growth Rate = \( \frac{$9.5\ trillion - $9\ trillion}{$9\ trillion} \times 100 = 5.6\% \)

Inflation Rate = \( \frac{113 - 111}{111} \times 100 = 1.8\% \)
Inflation: CPI and core CPI
Term Structure

The rest of the world
Chapter 1

Why Study Money, Banking, and Financial Markets?
Why Study Financial Markets?
1. Channel funds from savers to investors, thereby promoting economic efficiency
2. Affect personal wealth and behavior of business firms

Why Study Banking and Financial Institutions?
1. Financial Intermediation
   Helps get funds from savers to investors
2. Banks and Money Supply
   Crucial role in creation of money
3. Financial Innovation

Why Study Money and Monetary Policy?
1. Influence on business cycles, inflation, and interest rates
FIGURE 1  Interest Rates on Selected Bonds, 1950–2005
Stock Market

Dow Jones Industrial Average

Money and Business Cycles

Money Growth Rate (M2)
Money and the Price Level

Index (1987 = 100)

Aggregate Price Level (GDP Deflator)
Money Supply (M2)
Money Growth and Interest Rates
Fiscal Policy

Actual Federal Budget Balance to GDP ratio (fiscal yrs)

CBO Baseline

Extending EGTRRA & JGTRRA
CBO Debt Projections

Source: CBO (Aug. 2006)
How We Study Money and Banking

Basic Analytic Framework
1. Simplified approach to the demand for assets
2. Concept of equilibrium
3. Basic supply and demand approach to understand behavior in financial markets
4. Search for profits
5. Transactions cost and asymmetric information approach to financial structure
6. Aggregate supply and demand analysis
Appendix: Definitions

Aggregate Output
Aggregate Income

Distinction Between Nominal and Real
Nominal = values measured using current prices
Real = quantities, measured with constant prices

Aggregate Price Level

GDP Deflator = \frac{\text{nominal GDP}}{\text{real GDP}}

\text{GDP Deflator} = \frac{\$10 \text{ trillion}}{\$9 \text{ trillion}} = 1.11

Consumer Price Index (CPI) price of “basket” of goods and services