

The Financial System
(provisional, subject to revision)

1. INTRODUCTION

This course will review the basics of monetary policy, including how the money supply is controlled and the role of the banking system. The course will then cover the principles of asset pricing, the role of collateral constraints and other informational problems in banking, and how those factors induce feedback loops in the macroeconomy. A portion of the course will address the analysis and implications of financial regulation or non-regulation, especially in regard to the financial crisis of 2008. Prerequisites: Econ 301/311 and 302/312, Econ 310.

2. OFFICE HOURS

Prof. Menzie Chinn: MW 2-3
7418 Social Sciences Bldg., 262-7397
e-mail: mchinn@lafollette.wisc.edu

Updated information will be posted on the course website,
http://www.ssc.wisc.edu/~mchinn/web435_s14.html.

3. SCHEDULE AND READINGS

There is no textbook. However, for background, one can refer to Stephen Cecchetti and Kermit Schoenholtz, *Money, Banking and Financial Markets*, 3rd Edition (McGraw-Hill, 2011) (abbreviated **CS** below). A substitute is Frederic Mishkin, *The Economics of Money, Banking and Financial Markets*. There is one required book, Chinn and Frieden, *Lost Decades* (W.W.Norton, 2012) (abbreviate **CF** below). Required readings are listed below, and additional required and optional readings will be assigned during the semester from the Web. You will also be expected to refer to the following weblog for current macroeconomic commentary: <http://www.econbrowser.com>.

LEC.	DATES	CS	CF	READING	TOPICS
1	1/22	1-3	Pref		Introduction
2-3	1/27-29			IS-LM, PCO	IS-LM
4	2/3				Class cancelled
5	2/5		1	ADAS1, ADAS2	AD-AS
6-7	2/10-12	4-6			Interest rates
8-9	2/17-19	7		EHTS	Term structure of interest rates
10-11	2/24-26	8		Asset prices	Asset prices, EMH, News

LEC.	DATES	CS	CF	READING	TOPICS
12-13	3/3-5	11			Financial structure
14	3/10	12-13			Banks and nonbanks
15	3/12	14		BBS	Banking regulation
16	3/24	15-16			Central banks: Federal Reserve/ECB
17-18	3/26-3/31	17		MSP	Money supply process
19	4/2	18		Ru, Ham	Monetary policy
20-21	4/7-9			BB	Credit channel
22	4/14		2	BGG	Financial accelerator
23	4/16				Midterm
24-25	4/21-23	9	3	CJS	Derivatives, CDOs
26-27	4/28-4/30		4-5	GHKS, Br.	Financial crisis
28-29	5/5-7		7-8	DFP, ACRW	Post-crisis reforms

- ISLM: Notes on IS-LM
- PCO: Notes on Transactions and Portfolio Crowding Out
- AD-AS1: Notes on Aggregate Demand/Aggregate Supply
- AD-AS1: Notes on Aggregate Demand/Aggregate Supply w/Expectations
- EHTS: Notes on Expectations Hypothesis of Term Structure
- Asset Prices: Notes on Asset Pricing, “News”, and EMH
- BBS: Notes on Bank Balance Sheets
- MSP: Notes on Money Supply Process
- Ru: Glenn Rudebusch, “The Fed’s Monetary Policy Response to the Current Crisis,” *FRBSF Economic Letter* 2009-17, May 22, 2009.
- Ham.: James Hamilton, “Concerns about the Fed's New Balance Sheet, in *The Road Ahead for the Fed*,” edited by John D. Ciorciari and John B. Taylor, Stanford: Hoover Institution Press, 2009.
- BB: Ben Bernanke, Alan Blinder, “Credit, Money and Aggregate Demand,” *American Economic Review* 78(2) (May, 1988), pp. 435-439.
- BGG: Bernanke, Gertler and Gilchrist, “The Financial Accelerator and the Flight to Quality,” *The Review of Economics and Statistics* 78(1). (Feb., 1996): 1-15.
- GHKS: David Greenlaw, Jan Hatzius, Anil K Kashyap, Hyun Song Shin, “Leveraged Losses: Lessons from the Mortgage Market Meltdown,” paper presented at US Monetary Policy Forum Conference, February 29, 2008.
- Br: M. Brunnermeier, Deciphering the Liquidity and Credit Crunch, 2007-2008,” *Journal of Economic Perspectives* 23(1) (Winter 2009).
- CJS: J.D. Coval, J. Jurek, E. Stafford, “The Economics of Structured Finance,” *Harvard Business School Working Paper* 09-060. Published *Journal of Economic Perspectives* 23(1) (Winter 2009).
- DFP: Mathias Dewatripont, Xavier Freixas, and Richard Portes, editors, *Macroeconomic Stability and Financial Regulation: Key Issues for the G20* (CEPR, 2 March 2009), pp. 91- .
- ACRW: Viral Acharya, Thomas Cooley, Matthew Richardson and Ingo Walter, “Dodd-Frank: One Year On...” *Dodd-Frank One Year On* (CEPR/Vox, 2011).

4. GRADING

Letter grading is determined as follows:

10% Problem sets (×3)

45% Midterm (×1)

45% Term paper (×1)

Late assignments will not be accepted for credit. Although the problem sets do not constitute a large portion of the grade, I strongly encourage you to do the assignments in a timely and serious fashion. The problem sets provide valuable information regarding your grasp of the concepts.

5. THE TERM PAPER

A 15 page term paper will be due at the end of the semester. You will have latitude in terms of the choice of topic. However, I will be able to give you more guidance on certain topics than others. Additional details regarding this assignment, along with suggested readings, will be provided later in the term.

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