

**Department of Economics
University of Toronto**

**ECO2500HF – Monetary Theory
Fall 2010**

Instructor:

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Office Hours: **Tuesday 10:30AM – 11:30AM.**

Course objectives:

This course explores a wide range of topics on monetary theory. The strategy of the course is to examine simple models to examine the importance of money, banks, and other financial institutions in the way economies work. The topics examined in this framework include: role of money, determination of the medium of exchange, effects of inflation, effects of monetary shocks on output, role of banks, control of the money supply, and effect of the National Debt on saving and investment.

Course materials:

Required: Bruce Champ and Scott Freeman, "Modeling Monetary Economies," Cambridge University Press. Second edition. ISBN: 0521789745.

The approach of this textbook is to teach monetary economics from first principles using the classical paradigm of rational agents in a market setting. The text builds on a simple, clear monetary model and applies this framework consistently to a wide variety of monetary questions.

Grade allocation:

Mid-term test (Oct 19, 4-5PM)	35 %
Problem sets	15 %
Final exam	50 %

There will be around 5 problem sets. Answering these problem sets is an integral part of the learning experience of this course. The due date of the problem sets will be posted in the course web site. There will not be a make-up test. If students miss a test, they should provide me with proper justification during the week following the test. If this justification is well documented and compelling, the weight of the missed test will be transferred to the final exam.

Announcements:

Please, make it a habit of checking the course web page for announcements.

Academic misconduct:

Students should note that copying, plagiarizing, or other forms of academic misconduct will not be tolerated. Any student caught engaging in such activities will be subject to academic discipline ranging from a mark of zero on the assignment, test or examination to dismissal from the university as outlined in the academic handbook. Any student abetting or otherwise assisting in such misconduct will also be subject to academic penalties.

Course Outline:

- 1. A simple model of a monetary economy.**
- 2. Inflation**
- 3. International monetary systems**
- 4. Effect of price surprises**
- 5. Capital**
- 6. Liquidity and financial intermediation**
- 7. Bank risk**
- 8. Central banking and the money supply**
- 9. Money stock fluctuations**

The readings and the pages in the book covered for each topic will be posted in the course web page.

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PRELIMINARY LIST OF READINGS

Textbook:

B. Champ and S. Freeman, *Modelling Monetary Economies*, 2nd edition, Cambridge Univ. Press, 2001 (CF).

The following list of readings is preliminary to give an indication to students of the type of material the course will cover. As the course progresses, the required reading will be specified in the course web page.

1. A Simple Model of Money

- CF, Ch. 1, pp. 3-27.
- Samuelson, P.A. 1958, "An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money," *Journal of Political Economy* 66 (December): 467-82.

2. Inflation

- CF, Ch. 3, pp. 48-72.
- Meh, C. and Y. Terajima, 2009, "Unexpected Inflation and Redistribution Wealth in Canada," *Bank of Canada Review*, (Spring).

3. International Monetary Systems

- CF, Ch. 4, pp. 74-96.
- Ragan, C. 2005, "The Exchange Rate and Canadian Inflation Targeting," *Bank of Canada Working Paper* 2005-34.

4. Effect of Price Surprises

- CF, Ch. 5, pp. 99-112.
- Bank of Canada, 2006, "Renewal of the Inflation-Control Target: Background Information," (November).
- Goodfriend, M. 2007, "How the World Achieved Consensus on Monetary Policy," *Journal of Economic Perspectives*, pp. 47-68.

5. Money and Capital

- CF, Ch. 6, pp. 117-128 and 134-137.

- Tobin, J. 1965, "Money and Economic Growth," *Econometrica* 33 (October), pp. 671-84.

6. Liquidity and Financial Intermediation

- CF, Ch. 7, pp. 138-149.
- Kritzman, M. 1993, "What Practitioners Need to Know About the Term Structure of Interest Rates," *Financial Analysts Journal* (August).
- Diamond, D.W., 1984, "Financial Intermediation and Delegated Monitoring," *Review of Economic Studies* 51 (July), pp. 393-414.

7. Bank Risk

- CF, Ch. 12, pp. 214-229.
- Diamond, D.W. and P.H. Dybvig, 1983, "Bank Runs, Deposit Insurance, and Liquidity," *Journal of Political Economy* 91, pp. 401-19.

8. Central Banking and the Money Supply

- CF, Ch. 8, pp. 150-168.
- Taylor, J. 2008, "The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong," in *Festschrift in Honour of David Doye's Contributions to Canadian Public Policy*, Bank of Canada.

9. Money Stock Fluctuations

- CF, Ch. 9, pp. 169 -184.
- Romer, C. and D. Romer, 2004, "A New Measure of Monetary Shocks: Derivation and Implications," *American Economic Review* (September), pp. 1054-84.