

Economics 323
Money, Financial Intermediation and the Economy
Spring 2007

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Office Hours: Drop in office hours Monday, Wednesday and Friday 9 am – 2 pm.
And by appointment

Course Description:

This course examines the banking and monetary systems of the US and their link to the macroeconomy. Our focus is on the determination of interest rates, the role of banks in creating money, the role of the Federal Reserve System in managing the money supply, and monetary theory and policy.

Prerequisites: E&B 211 and 212

Reading Material:

Required: Croushore, Dean, Money and Banking: A Policy-Oriented Approach

Croushore, Dean, Study Guide: Money and Banking: A Policy-Oriented Approach

Complete the self-test with each chapter and practice problems posted on Blackboard.

Board of Governors of the Federal Reserve System, The Federal Reserve Purposes & Functions

http://www.federalreserve.gov/pf/pdf/pf_complete.pdf

Wall Street Journal

We will discuss articles every week.

Course Requirements and Approximate Grading:	Percentage
Exam 1 (Monday, March 5)	15%
Exam 2 (Wednesday, April 18 or Friday, April 20)	15%
Writing Assignment 1	20%
Writing Assignment 2	20%
Writing Assignment 3	20%
Class Participation/ Attendance	10%

Course information will be posted on **Blackboard**. You will need to “enroll” during the first week of class. Students should regularly check the course page for announcements, assignments and other useful information. **If you miss class, check Blackboard for any missed assignments and announcements.**

Class Participation/ Attendance:

Class participation is strongly encouraged. Remember if you are absent from class you cannot participate. Excessive absenteeism will be penalized. Participation in discussions is important and may be a critical factor in your final grade.

Exams:

Exams will be given on the announced dates. If you have a conflict with one of the exam dates, you must tell me before the exam preferably as far in advance as possible. An excused exam will result in a re-weighting of your course grade. An unexcused exam will result in a zero.

Requests for a change in your grade on an exam must be made in writing within one week of the return of the exam. You must identify where and why you disagree with my assessment of your work. After reviewing your work I will meet with you during my office hours to discuss it. I reserve the right to make any additional corrections if they come to my attention.

Exams are an opportunity for you to demonstrate your mastery of the material. Mastery of the material includes more than just reproducing the examples covered in the text and in class. It includes showing you have the ability to apply the concepts we are learning to problems you haven't seen before.

Remember learning is more than knowing how to use a tool, it is recognizing when to use it.

Writing Assignments:

Writing is a process. It is not sitting in front of the computer the night before an assignment is due. The first step is getting down the ideas you want to express (brainstorming). The second step involves organizing these ideas and forming an outline. In the third step you develop a rough draft. The final step involves revising the rough draft(s) until you have clear, well-organized and well-written paper.

There are three writing assignments. The details of each assignment are attached.

Assignment 1: summarize (3-5 pages) an article from a Federal Reserve publication, post an abstract (1 paragraph) to Blackboard.

Assignment 2: literature review (8-10 pages)

Assignment 3: FAIR model simulation (10-12 pages including tables and graphs)

For each draft you must turn in two copies: one for me and one for the WA. After you turn in your draft you will meet with the WA. Late papers will be marked down one letter grade for each day they are late. Poorly attempted first drafts will be marked down as well. In addition, you must attach your first draft from your meeting with the WA to your final paper. I will not accept any paper that has not first been reviewed by your WA.

The dog eating your paper or your computer crashing is not an acceptable excuse for a late paper; therefore, you should regularly back up your work and print hard copies.

Writing Associate (WA): The College Writing Program helps to integrate writing in courses in all disciplines. The program trains WAs to help facilitate your writing not proofread and edit your writing. The WA is an intelligent, experienced reader/writer who will engage you in discussions so that you can improve your drafts. All students are required to meet with their WA for each draft. All meetings with your WA are in Pardee 319. If you miss your meeting, your paper will be marked down one letter grade.

You may also get additional help with your writing during drop-in service (Sunday-Thursday, 6-9 pm) in Pardee 319. Attending drop-in service is **not** a substitute for your scheduled meeting with the WA.

Library Session: On **Wednesday, March 7** and **Friday, March 9** the class will meet in Skillman 004 where reference librarian Rebecca Metzger will give a presentation on researching papers for your second writing assignment (literature review). **Attendance is mandatory.**

Other Policies:

Cheating and plagiarism are not tolerated within the Lafayette community. Any student who violates the regulations on intellectual honesty will be subject to the penalties described in the Student Handbook. Read pages 70-72 of the Student Handbook for a detailed description of what constitutes plagiarism.

The class is not graded on a strict curve; everyone can do well.

Course Outline and Readings

A. Introduction

Chapter 1, Money and Banking

Chapter 2 (pages 15-24), Money and Banking

B. Money, Interest Rates and Banking

Chapter 3, Money and Banking

Chapter 4 (pages 74-79), Money and Banking

Chapter 5, Money and Banking

Chapter 6, Money and Banking

Chapter 7, Money and Banking

Chapter 8, Money and Banking

C. Monetary Policy

Chapter 15, Money and Banking and Chapter 1, The Federal Reserve Purposes & Functions

Chapter 16, Money and Banking and Chapter 3, The Federal Reserve Purposes & Functions

Chapter 17, Money and Banking and Chapter 2, The Federal Reserve Purposes & Functions

Chapter 18

D. FAIR Model

<http://fairmodel.econ.yale.edu/main2.htm>

Writing Assignment 1

Due January 29, in class: Answers to Greenlaw's Chapter 6, Table 6.1 questions

Due February 7, in class: 1st draft and abstract

Due February 16, 5 pm: Final paper and revised abstract

Articles will be distributed the first day of class.

Read chapter 6 of Steven Greenlaw's Doing Economics (copy provided). On page 99 in Table 6.1, Greenlaw proposes 7 questions to guide reading academic articles. Provide answers to those 7 questions about your article.

Summarize (4-5 pages) an article from a Federal Reserve publication related to the course material. Write a one paragraph abstract and post it on Blackboard's Discussion Board.

An abstract is a summary of the main points of a paper. It must make sense as a stand-alone paragraph. It cannot assume that the reader has any prior knowledge other than general knowledge of economics.

In academic articles, economists generally include an abstract to convey the importance of their work and to capture readers' attention. In economics, generally the abstract will include the question or questions the author attempts to answer; if important, the methodology the author uses; and finally, the findings of the author. Another way to think of the abstract you are writing is that it should be a paragraph summary of the Federal Reserve publication.

Example

Can Central Banks Target Bond Prices?

By Kenneth Kuttner

This paper addresses the possible role of bond prices as operating or intermediate targets for monetary policy. The paper begins with a brief review of the mechanisms through which a central bank could, in theory, influence long-term interest rates, and continues with a brief narrative overview of debt management policies in the U.S., tracing their effects on the maturity distribution of outstanding publicly-held Treasury debt and the composition of the assets held by the Federal Reserve System. The empirical section presents new econometric evidence on the effects of these policies on expected excess holding returns ("term premia"), demonstrating that changes in the Fed's holdings of long-term securities have had statistically significant and economically meaningful effects on the term premia associated with Treasury securities with maturities in the two- to five-year range.

Writing Assignment 2

Due March 21, in class: Annotated bibliography

Due March 28, in class: 1st draft

Due April 6, 5 pm: Final paper

Write a literature review on a topic related to the course material. You may use the topic in the article that you summarized for the first writing assignment or you may examine the abstracts your classmates posted on Blackboard to find other acceptable ideas. If you have any question about whether your topic is acceptable, please contact me.

What is a literature review?

A literature review is an organized and synthesized summary of a number of academic articles (5 to 10) related to a chosen topic. A literature review should not summarize each article separately but find common themes throughout the articles, identify areas of controversy, and possibly, formulate questions that need further research. You are building an account of what has been published by researchers. For example, suppose your topic is the pros and cons of inflation targeting. You might find several articles on the success/failure of inflation targeting, some on the prospects of inflation targeting in the U.S. and a few theoretical papers on the optimality of inflation targeting as a monetary policy regime. The literature review might be divided into these sections with the use of sub-headings.

What is an academic article?

An academic article is written by a trained research economist not a newspaper or magazine reporter. Although many academic articles are too technical for undergraduates, most articles written for Federal Reserve publications are accessible. In addition to the Federal Reserve, there are several other sources (Journal of Economic Perspectives, The American Economist, The Economists' Voice, and World Economics) of less technical articles. I encourage you to explore other journals such as the American Economic Review and the Journal of Money, Credit and Banking that on occasion have less technical articles.

How to get started.

Pick a topic. Go to the library. Look up a dozen papers on your topic. Read them. Write summaries as you read. Contemplate common themes, areas of controversy among the papers. Write the literature review.

Often once you find one or two papers on a topic you can use the reference list at the end as a guide to related papers. However, you should still conduct a search to make sure you haven't missed a large portion of the literature. You should not just read and write on the first ten papers you find.

Reference format and use of footnotes.

Reference articles by author's name and date of publication. Use footnotes to elaborate a point not to cite articles. For example, Julie Smith (2004) finds that the weighted median inflation rate is a good forecaster of headline inflation. Alternatively, the weighted median is found to be a

good forecaster of headline inflation (Smith, 2004). Cite the Smith publication in the reference list at the end of the paper. You may use any recognized citation format in the reference list.

What is an annotated bibliography?

An annotated bibliography is a list of resources on a certain topic with a description of each resource. Each entry in an annotated bibliography should include all the information you would normally include in a list of works cited. The bibliographic information is followed by an annotation, which can be just a few sentences and often both describes and evaluates the contents of the item.

For your annotated bibliography, you should group your references by which sub-heading it would appear under. An academic article may appear under more than one sub-heading and the annotation would be slightly different when it appears under two distinct sub-headings.

<http://ww2.lafayette.edu/~library/guides/bibliography.html>

Writing Assignment 3

Due May 2, in class: 1st draft

Due May 10, 5 PM: Final paper

During the final two weeks of class you will learn how to use the FAIR model (US model), (<http://fairmodel.econ.yale.edu/main2.htm>). The US model is a 30 equation model of the US macroeconomy developed by Ray Fair of Yale University.

Economists often examine implications of theoretical models and results from empirical analysis in the same paper. This assignment combines writing about economic theory and data.

Choose a recent recession (1991 or 2001) and re-simulate the economy by choosing a different path for monetary policy than the one chosen by Alan Greenspan and the FOMC.

Write a detailed report that includes the following: your choice of monetary policy, the macro theory behind your choice of policy and the predicted versus actual results of the simulation.

I suggest the following parts in your paper:

1. Summarize the actual economic history before and after the actual change in monetary policy. Describe the change in monetary policy. Take note of any variables that are of particular importance in your decision to change policy. **Use Beigebook and FRED data.**
 - a. GDP growth: [GDPC1](#) Real Gross Domestic Product, 1 Decimal
 - b. Consumer spending: [PCECC96](#) Real Personal Consumption Expenditures
 - c. Investment spending: [GPDIC1](#) Real Gross Private Domestic Investment, 1 Decimal
 - d. Government spending: [GCEC1](#) Real Government Consumption Expenditures & Gross Investment, 1 Decimal
 - e. Trade: [NETEXC](#) Real Net Exports of Goods & Services
 - f. Prices (Inflation): [GDPDEF](#) Gross Domestic Product: Implicit Price Deflator
 - g. Unemployment: [UNRATE](#) Civilian Unemployment Rate
 - h. Interest rates (term structure):
 - i. [TB3MS](#) 3-Month Treasury Bill: Secondary Market Rate
 - ii. [GS10](#) 10-Year Treasury Constant Maturity Rate
2. Briefly describe how monetary policy is supposed to work (AD/AS and IS/LM graphs).
3. Discuss why conducting policy with hindsight is easier than in real-time. **Compare Beigebook and revised data (FRED at St. Louis Fed).**
4. Discuss your simulation results. Consider how the variables listed above (most importantly, consider real GDP growth and inflation) are affected by your policy and evaluate whether the U.S. is better off or worse off using a welfare criteria measure (loss function) with your monetary policy or Greenspan's policy.