



APPLIES TO ACADEMIC YEAR 2004/2005

## GRA 6631 Monetary Policy

### Program

Advanced Specialization Course (MSc), Master of Business and Economics Program, Master of Science in Business, Master of Science in Business (Economics), Master of Science in Management

### Responsible for the course

Kai Leitemo

### Department

Economics

### Term

According to study plan

### ECTS Credits

6

Monetary policy is the single most important branch of economic stabilization policy. It influences the cost of obtaining funding for investment projects, it influences the cost of renting capital as well as labour and influences the business cycles and general demand for a firm's products. A better understanding of monetary policy is therefore a great advantage to almost everyone wanting to make good business decisions. This course gives you an advanced introduction to the art and science of monetary policy.

### Objective

During the past decade monetary policy has received increasingly more attention in economic policymaking. Monetary policy is now considered the main policy tool for providing macroeconomic stability. Many central banks have become "independent" and switched from strategies of targeting the exchange rate or money supply to targeting inflation directly. Through inflation targeting, monetary policy has been demystified and become more scientific as more and more research has been directed towards the question: how to stabilize inflation at the smallest cost in the form of fluctuations in output and employment.

In this course, participants will learn about the instruments and objectives of monetary policy. How does the central bank think when setting its policy interest rate under the different strategies? How does the central bank operate in the money market and what consequences do the operation have for long-term interest rates? How does monetary policy affect the macroeconomy? How is monetary policy coordinated with fiscal policy? How should monetary policy be designed if we want to stabilize inflation at the smallest cost in the form of fluctuations in inflation and output?

After the completion of the course, the student is expected to have obtained a good understanding of how monetary policy works and how central banks think when setting short-term interest rates. The course will be suitable for students wanting to work in business and governmental institutions, where a good understanding of stabilization policy is required, or students that simply want to read the financial newspapers with greater ease.

Monetary policy is an advanced course and is more mathematically oriented than its prerequisite course *Business Cycles*. The course will be taught by use of the whiteboard, and lecture notes will be provided when the textbooks do not cover the topics adequately. The course requires the students to work hard with the syllabus.

The following topics constitute the core of the course.

1. Indicators, targets and operating procedures in monetary policymaking. Terms structure of interest rates.  
Walsh, Chapter 9 and 10.

How does the central bank operate in the money market in order to control interest rates? Should the central bank use the interest rate or base money as their instrument? What are intermediate target variables? How can the central bank affect the term structure of interest rates?

2. The monetary-policy transmission mechanism. Theory and empirical evidence.  
Walsh, Chapters 1 and 5.

This part of the course discusses the channels of monetary policy: how the central bank can influence private sector decisions with respect to consumption, investment etc. We first discuss the empirical evidence and then go on to discuss economic theory in the Neo-Keynesian and New-Keynesian macroeconomic frameworks. Models of both closed and open economies are considered.

3. Monetary-policy strategy  
Walsh, Chapter 11. Blejer et al.

We discuss the design of monetary policy in order to achieve low inflation and output variability? How does different assumptions about private sector behaviour influence this strategy. We discuss the role of targeting vs simple monetary policy rules. Why does forecasting play a role in the design of monetary policy? How has inflation targeting been implemented in practice?

4. Coordination of macroeconomic policies  
Lecture notes.

How is fiscal and monetary policy coordinated? Does inflation targeting have any implications for the role fiscal policy plays in stabilization policy?

5. The optimal rate of inflation and the seigniorage. Other issues.

How much revenue can the government obtain by the printing of money? What is the optimal rate of inflation?

#### **Prerequisites**

GRA 6634 Business Cycles

#### **Compulsory literature**

Walsh, Carl E. 2003. *Monetary Theory and Policy*. 2nd ed. Cambridge, Mass., MIT Press. Chapter 1, 5-11.

Blejer, Ize, Leone and Werlang, eds. 2000. *Inflation Targeting in Practice: Strategic and Operational Issues and Application to Emerging Market Economies*. Washington D.C. : IMF. A compendium of articles.

#### **Recommended literature**

None

**Course outline**

1. The indicators and targets of monetary policy.
2. The monetary-policy transmission mechanism.
3. Monetary-policy strategy
4. Coordination of macroeconomic policies
5. The optimal rate of inflation and the seigniorage

**Computer-based tools**

Blackboard

**Course structure**

Lectures (36 hours)

**Evaluation**

Written mid-term exam (1 hour, 20%), a group project/presentation (10%) and written final exam (3 hours, 70%)

**Evaluation code(s)**

GRA 66311

**Aids at the examination**

Bilingual dictionary

**Makeup exam**

Next time the course is offered