



APPLIES TO ACADEMIC YEAR 2005/2006

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 more attention in economic policymaking. Monetary policy is now considered the main policy tool for providing macroeconomic stability. Many central banks have become independent of the government and has switched from strategies of targeting the exchange rate or money growth to targeting inflation and output directly. Through inflation targeting, monetary policy has been de-mystified 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 and monetary policy is required, or students that simply want to read the financial newspapers with greater ease.

Monetary policy is an advanced specialization 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 sets high requirement for student involvement for successful completion of the course, but we believe that it is among the finest of its kind in Europe.

Prerequisites

GRA 6634 Business Cycles

Compulsory literature

Books:

Walsh, Carl E.. 2003. Monetary Theory and Policy. 2nd ed. Cambridge, Mass., MIT Pres. Chapter 1, 5-11. A compendium of articles

Recommended literature

Course outline

1. Introduction: Indicators, targets and operating procedures in monetary policymaking. The monetary transmission mechanism and stylized facts of the effects of monetary policy. (Walsh, Chapter 1 and 9)
2. The credibility problem of monetary policy. The Kydland-Prescott/Barro-Gordon insights.
(Walsh, Chapters 8)

The credibility problems inherent in monetary policy is discussed. Why is commitment so important? Reputation and delegation as solution to the credibility problems.

3. New Keynesian economics and optimal monetary policy.
Walsh, Chapter 6 and 11.

The New Keynesian models for both the closed and the open economy are derived from microfoundations. We discuss optimal monetary policy under various forms of uncertainty and for different extensions to the model. This constitutes the main part of the course.

4. Coordination of macroeconomic policies

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. Other issues.

What is the optimal target for inflation?

6. The practical implementations of inflation targeting policies. Group projects.

Computer-based tools

Blackboard

Course structure

Lectures (36 hours)

Evaluation

Written mid-term exam (1 hour, 20%), a group project/presentation (20%) and written final exam (3 hours, 60%)

Evaluation code(s)

GRA 66311

Aids at the examination

Bilingual dictionary

Makeup exam

Re-takes are only possible at the next time a course will be held. When course evaluation consists of class participation or process elements, the whole course must be re-evaluated when a student wants to retake an exam. Retake examinations entail an extra examination fee.