GRA 6631 Monetary Policy

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

Responsible for the course
Kai Leitemo

Department
Economics

Term
According to study plan

ECTS Credits
6

This course gives you an advanced introduction to the art and science of monetary policy. Monetary policy is about setting (usually) the short-term interest rates in order to maximize social welfare. It is the single most important policy tool for avoiding destabilizing business cycles. The principles guiding monetary policy influence consumption and investment decisions - and thereby the overall demand for goods and services in the macroeconomy. A good understanding of how monetary policy works is a great advantage to almost everyone making decisions in private enterprises and households.

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 have 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.

Objective
In this course, participants will learn about the instruments and objectives of monetary policy. How does the central bank think when setting the interest rate? How does the central bank operate in the money market and what consequences does this policy have for long-term interest rates? How does monetary policy affect the macroeconomy? How can monetary policy best be 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 and interest.

Monetary policy is an advanced specialization course and is more mathematical demanding than its prerequisite course *Business Cycles.* The course will be taught by use of the whiteboard, and lecture notes will be provided when the textbook does not cover the topics adequately. The course sets high requirement for student involvement for successful completion of the course. At the end of the course, the students are expected to make a group presentation on a given topic relating to a monetary policy issue.

Prerequisites
GRA 6634 Business Cycles (or a similar graduate introduction to macroeconomics and business cycles.)

Compulsory literature
Books:
Walsh, Carl E. 2003. Monetary theory and policy. 2nd ed. Cambridge, Mass. : MIT Press. Chapters 1, 5, 6, 8, 9, 10 and 11.

Articles:
Kai Leitemo. 2004. A Game Between the fiscal and the monetary authorities under inflation targeting. European Journal of Political Economy. 20. pp. 709-724

Journals:
Clarida, Gali and Gertler. 1999. The Science of Monetary Policy: A new Keynesian perspective. Journal of Economic Literature. 37 (4). pp. 1661-1707

Other:
Kai Leitemo. A number of articles relevant for the topics will be distributed

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 (2003), chapters 1 and 9.

2. The credibility problem of monetary policy. The Kydland-Prescott/Barro-Gordon insights. Walsh (2003), 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 5, 6, 10 and 11. Clarida, Gali and Gertler (1999).

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 basic 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?
Leitemo (2004). Lecture notes.

5. Issues in the practical implementation of monetary policy.

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 accounts for 100 % of the final grade in the course GRA 6631.

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 me re-evaluated when a student wants to retake a exam. Retake examinations entail an extra examination fee.

Honor Code
Academic honesty and trust are important to all of us as individuals, and they are encouraged and promoted by the honor system. This is a most significant university tradition. The honor system is the responsibility of students. As faculty, we share the commitment to the ideals of the honor system.

At no time should notes or papers or personal consultations based on previous semesters of this course be used. As part of the honor code papers handed in as part of the course is, at the discretion of the professor, scanned for plagiarism. We are using Safe Assignment in Black Board for this purpose. Any violation of the honor code will be dealt with in accordance with BI's procedures on cheating. These issues are a serious matter to everyone associated with the program. They are at the heart of

the Honor Code and academy integrity. If you have any questions about your responsibilities under the honor code, please ask.