Monetary Economics: Macro Aspects, 2/2 2004

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Plan for today:

1. Welcome

2. Various "logistics" of the course

3. Overview of course contents:

   a) What are the main themes?

   b) Which subjects are covered?

4. Plan for next lecture

Welcome

- Language?

- This is an "English" course....any non-Danish students here?

        Welcome to **all!**

- Who am I? Why am I here?

    – (...check out: **www.econ.ku.dk/personal/henrikj/**)

Various "logistics" of the course

- Curriculum:

  – Carl Walsh (2003): *Monetary Theory and Policy, Second edition* (The MIT Press) is main text. Buy it...

  – A number of recent journal articles and working papers:

    * Most available electronically through the Institute Library's web-site: **www.econ.ku.dk/library/** (go for "Journals")

    * Some available electronically through the course web-site

    * Note: Do *not* spend time/energy/money downloading everything on the reading list now (as some may be taken off the reading list during the semester)

  – Note: In several instances the book chapters and articles will contain sections that are not *required* reading, but only *recommended*. This is made clarified during the course and in the finalized — and exam-relevant — curriculum (available at the end of the semester)

- Exam: Four hours, closed-book written exam (tentative date June 18)

- Course web page: **www.econ.ku.dk/personal/henrikj/monec2004/**

- *Imperative* to visit on a regular basis! It will feature (among other things):

  – "Breaking News": Where are we headed in the next lectures? What other important stuff has happened/is going to happen?

  – **Lots** of downloadable stuff:

    * Lecture slides

    * Recapitulation info on past lectures (what did **I** put emphasis on?)

    * Various expository notes and exam-style exercises

    * (note that the book has exercises)

    * "F.A.Q." section: Send me questions by e-mail; and they will (along with an answer) be posted there. **If you** are in doubt about something, chances are high that others are too. Everything is **anonymous,** so only I am sticking my neck out....

    * General links of relevance

- Please comment on the web-page as we move along!

- Check out last year's course webpage to see lots of examples of the above: **www.econ.ku.dk/personal/henrikj/monec/**

- Teaching mode:

  – "Slide based"

  – Slides are available at the start of the lectures (so you can take notes on them)

  – Slides are subsequently posted on web-page

  – Slides will sometimes include computations, which are not covered as such in lectures

    * => You should always get the slides!

  – **For variation:**

    * A few lectures could — upon demand — be spent on doing exercises (either by YOU or me)

- E-mail list:

  – To get last-minute information on, e.g., cancellations, sign up on the e-mail list!

    => Send me your e-mail address with "Macro Aspects" in the subject line

  – (if you just write "hi," or leave the subject line empty, I delete the mail automatically!)

- CANCELLATION INFORMATION: LECTURES ARE **CANCELLED** ON MONDAY, MAY 17

Overview of course contents

a) **What are the main themes?**

- How does monetary policy affect macroeconomic aggregates?

  – I.e., how can the central bank affect, e.g., output, employment, consumption and inflation?

- What characterizes "good" monetary policymaking?

  – I.e., what should the central bank aim to accomplish?

  – I.e., which are the appropriate monetary policy regimes?

- Questions are addressed within a variety of modern (and durable classical) theoretical models

  – Although mainly a theoretical course, empirical relevance of theories is not neglected!

- Theories are **mathematically founded**

  – Intuition will be **very** important, but you **must** master macroeconomic theory at a level comparable to, e.g., David Romer's "Advanced Macroeconomics" (basic intertemporal optimization, analysis of dynamic systems, rational expectations)

  – I.e., you should have taken Copenhagen 3. year macroeconomics

b) Which subjects are covered?

(for literature, see the preliminary plan)

Subject 1: Introduction and "Does monetary policy matter for output?" (1 week)

- What are the "stylized facts" on the relationship between monetary policy and macroeconomic aggregates in the short and long run?

- What are the basic empirical problems in assessing this question?

- Can empirical evidence (on, e.g., the effect of money on output) be readily used for policy guidance?

Subject 2: Money's role in flexible-price general equilibrium models (3 weeks)

- What are the effects of money in micro-founded (private-sector optimal behavior) models with flexible prices?

- Do the effects match the (in particular, *long run*) stylized facts?

- "Benchmark" dynamic models and solution techniques (optimization, linearization around steady state; simulations)

- Basically "Ramsey models" with money introduced

- Examples:

  – Models with money in the utility function
  – Models with "cash-in-advance" constraints
  – Models where money plays an important role for public finance (inflation as a tax)

Subject 3: Money's role with incomplete nominal adjustment (1 week)

- What if prices and wages do not adjust instantaneously?

  – E.g., due to informational problems (Lucas' famous "misperceptions" model)

  – E.g., due to contractually fixed prices or wages

- Are the effects of monetary policy then more prominent and in accordance with the stylized facts (in particular, in the *short and medium run*)?

Subject 4: Rules versus discretion: Credibility problems (I) (1 week)

- Strategic issues in monetary policymaking

- Should monetary policy follow a fixed rule, or follow a "discretionary" pattern (i.e., continuously reconsider policy in light of changes in the state of the economy)?

- Which type of policymaking is "credible"?

- How can potential credibility problems — e.g., leading to excessive inflation — be overcome?

- Is, e.g., a politically independent central bank desirable?

- I.e., focus on how monetary *institutional framework* (legislation) matters

Subject 5: Operating Procedures, Interest Rates and Monetary Policy (2 weeks)

- How is monetary policy conducted in the real world?

  – I.e., how is policy implemented? What are the *operating procedures*?

  – What can/does the central bank control; what can/does it not control?

- What are central banks using as the monetary policy instrument?

  – Interest rates or the money supply?

- Example of interest rate policy rules in small simulation model

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Subject 6: Monetary policy conduct in "New Keynesian" settings: Credibility problems (II) (2 weeks)

- Newest branch of models for monetary policy analysis

- Dynamic, micro-founded models with sticky prices

- Suitable for characterization of **optimal** monetary policy

- Credibility problems in stabilization policy: Can they be alleviated? And through which monetary policy strategy(ies)?

- The issue of proper *institutional framework* revisited

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Subject 7: Open-economy Aspects and Monetary Policy Coordination (2 weeks)

- Monetary policymaking in open economies: the exchange rate channel

- Multi-country models with macroeconomic interdependencies

- What are the "spill-overs" of unilateral policymaking?

- Is internationally coordinated monetary policy desirable, and what characterizes it?

Subject 8: Inflation Targeting (2 weeks)

- Topical issue as several countries have adopted this policy regime

- What is inflation targeting?

- What are the implications for monetary policymaking?

- How can inflation targeting be modelled?

Subject 9: Transparency of Monetary Policymaking (1 week)

- Another topical issue

- Should central banks be open/transparent about their policy intentions?

- Or should central banks just "do their stuff" without explanations?

- Are their flexibility hampered by transparency?

- Can "secrecy" in monetary policymaking *ever* be desirable?

Plan for next lecture

1. What are the "stylized facts" about money and economic aggregates?

2. Empirical problems/issues

Literature: Walsh (2003, Chapter 1)