

Introduction and Course Overview

ECON 40364: Monetary Theory & Policy

Eric Sims

University of Notre Dame

Spring 2022

Readings

- ▶ Friedman, *Money Mischief* Ch. 1 “The Island of Stone Money”

Monetary Theory and Policy

- ▶ **Investopedia** defines **monetary theory** as “a set of ideas about how monetary policy should be conducted within an economy.”
- ▶ **Wikipedia** defines **monetary policy** as “the process by which the monetary authority of a country, like the central bank or currency board, controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency ... Further goals of a monetary policy are usually to contribute to economic growth and stability, to lower unemployment, and to maintain predictable exchange rates with other currencies.”

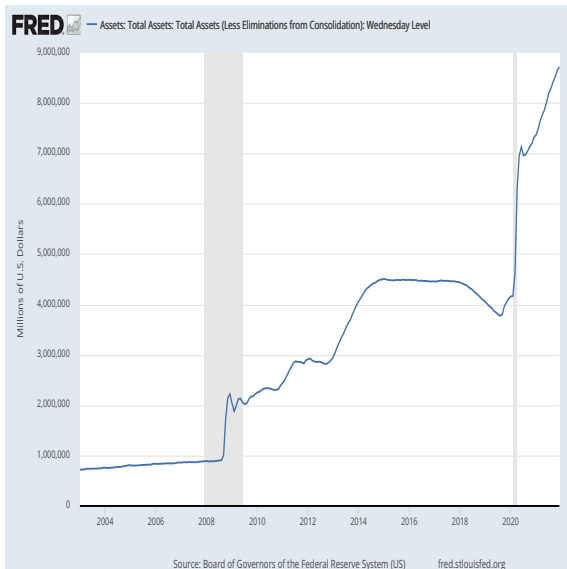
Questions

- ▶ In this course we'll be focusing on a series of interrelated questions:
 1. What is money? What determines the supply of money? The demand for money? The price of money?
 2. What are central banks? Why are they important? What are important design features? Should they be independent?
 3. What is liquidity? Why is liquidity important?
 4. What determines interest rates? Why are they important? Why are there so many?
 5. What are banks and bank-like institutions, why are they important, and why are they regulated?
 6. How should central banks conduct monetary policy in normal times?
 7. What are financial crises? How should central banks react to financial crises? How can central bank policy be structured to eliminate or limit financial crises?
 8. What is going on with central bank responses to COVID-19?

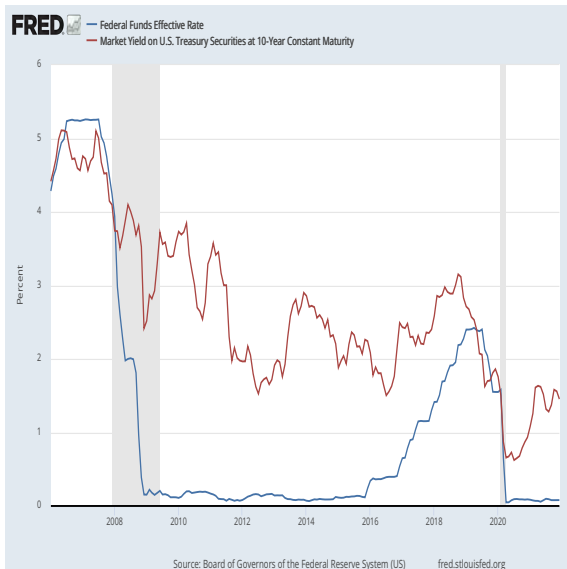
Big Issues in Monetary Policy at Present

1. Explosion of central bank balance sheets
2. Extremely low interest rates
3. Inflation running hot
4. Changes in Federal Reserve “Longer-Run Goals and Monetary Policy Strategy” in August 2020

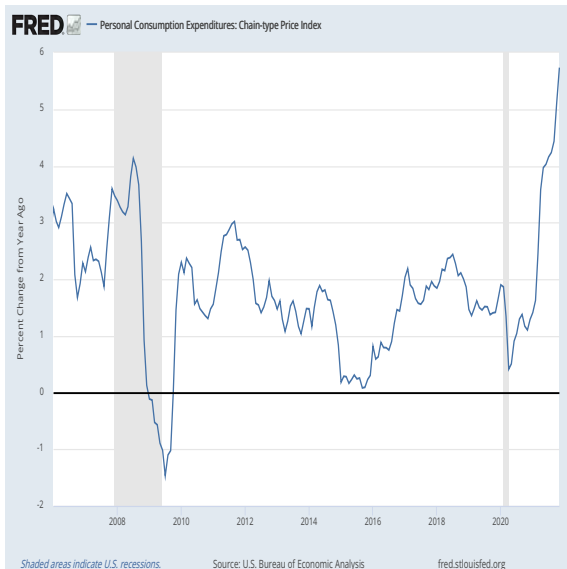
Fed Balance Sheet



Interest Rates



Inflation



Changes to Framework in August 2020

Among the more significant changes to the framework document are:

- On maximum employment, the FOMC emphasized that maximum employment is a broad-based and inclusive goal and reports that its policy decision will be informed by its "assessments of the *shortfalls* of employment from its maximum level." The original document referred to "*deviations* from its maximum level."
- On price stability, the FOMC adjusted its strategy for achieving its longer-run inflation goal of 2 percent by noting that it "seeks to achieve inflation that averages 2 percent over time." To this end, the revised statement states that "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time."
- The updates to the strategy statement explicitly acknowledge the challenges for monetary policy posed by a persistently low interest rate environment. Here in the United States and around the world, monetary policy interest rates are more likely to be constrained by their effective lower-bound than in the past.

Lecture Slides

- ▶ Lecture slides will be made available on the course website through **Canvas**
- ▶ Important terms or items will be highlighted in **blue**, while links to outside readings or websites will be in **orange**

Syllabus and Course Logistics

Structure of the Course

- ▶ The course as I have designed it is not quite as linear as I would like, in part because the development of money and central banking has not been all that linear
- ▶ The course will be divided into three parts:
 1. **Traditional monetary theory and conventional monetary policy:** money supply, money demand, monetary policy as a macroeconomic stabilization tool, central banks and independence
 2. **Topics in finance and banking:** bond pricing, term structure of interest rates, stock market, information asymmetry and financial structure, and banking
 3. **Financial crises and unconventional monetary policy:** Great Depression, Great Recession, unconventional monetary policy, lender of last resort, COVID-19

Evaluation

- ▶ **Problem Sets:** 5 of them, worth 25 percent of course grade (5 percent each), due roughly every two-to-three weeks
 - ▶ May be worked on collaboratively, but each individual must turn in own problem set
- ▶ **Quizzes:** 11, administered virtually through Canvas Thursday afternoon to Friday, more or less weekly; multiple choice/true-false; drop lowest (20 percent of course grade)
- ▶ **Midterm:** March 3 in class (25 percent of course grade)
- ▶ **Final:** May 4, 10:30-12:30 (30 percent of course grade)
- ▶ Can keep track of your grades on Canvas

About Me

- ▶ Professor and Department Chair, Dept. of Economics, Universitatis Dominae Nostrae a Lacu
 - ▶ BA, Trinity University, 2003
 - ▶ **Miracle in Mississippi**
 - ▶ PhD, University of Michigan, 2009
 - ▶ Don't get the wrong picture
 - ▶ Wife proud Lewis Hall Chicken
 - ▶ Signed Charlie Weis picture in office
- ▶ I am Roman Catholic
- ▶ And I believe in **Bigfoot**



Bigfoot



Family

