

Introduction and Course Overview

ECON 40364: Monetary Theory & Policy

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Spring 2025

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.”

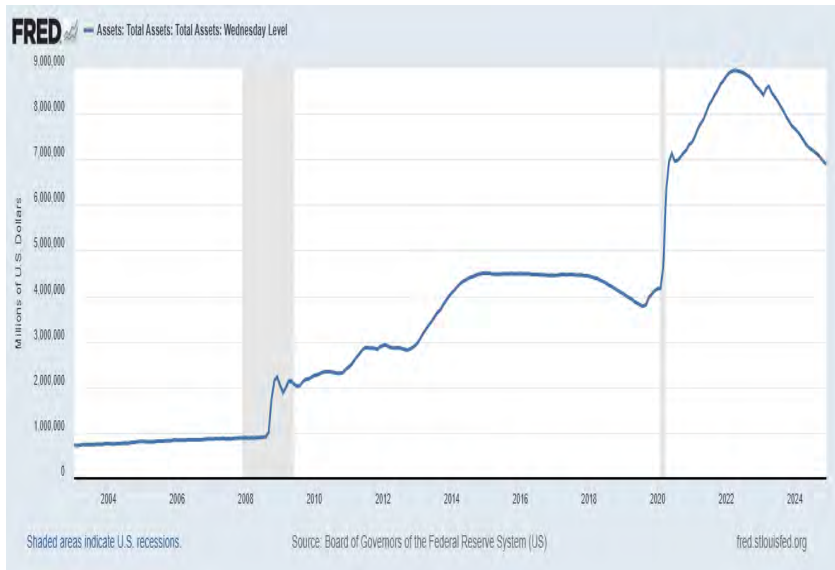
Questions

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?

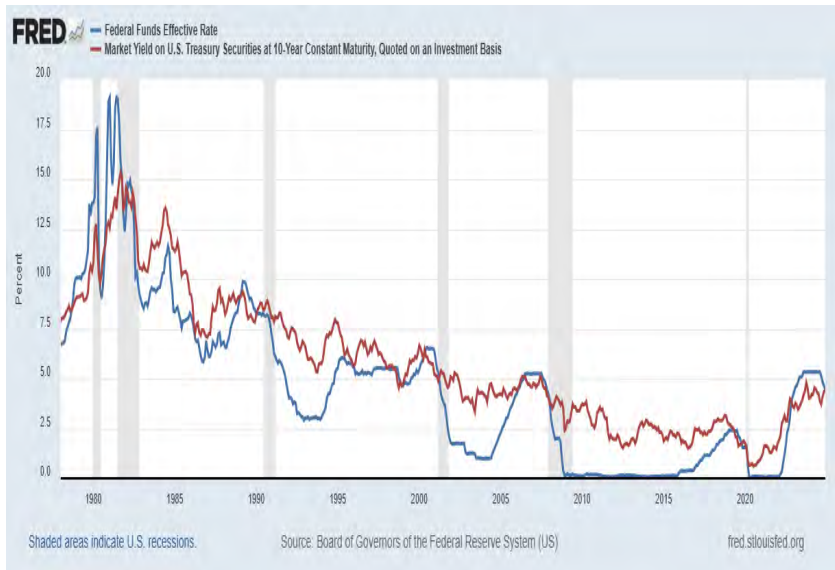
Big Issues in Monetary Policy at Present

1. Explosion of central bank balance sheets
2. Extremely low interest rates followed by higher rates
3. Extremely high inflation post-COVID, followed by inflation coming down but not all the way to target
4. Changes in Federal Reserve “Longer-Run Goals and Monetary Policy Strategy” in August 2020 and upcoming review in 2025

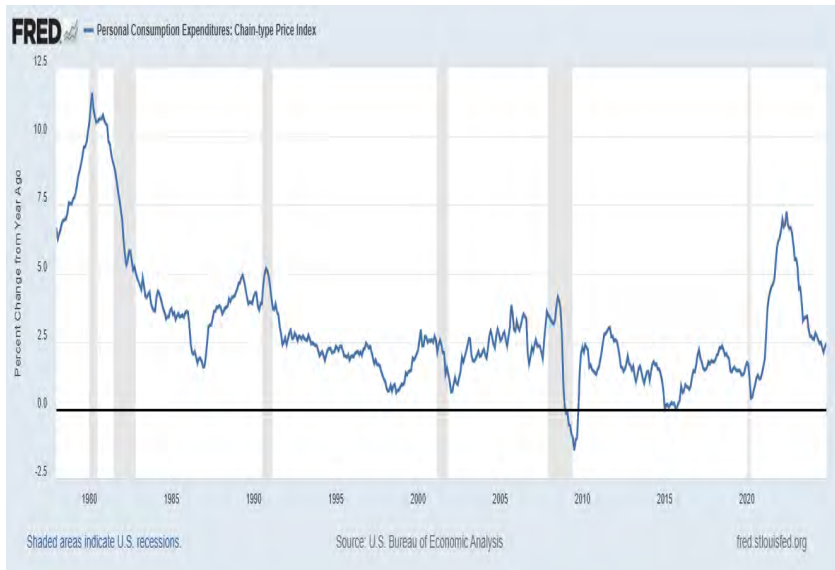
Fed Balance Sheet



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.

Upcoming Framework Review

1/6/25, 9:10 AM

Federal Reserve Board - Federal Reserve announces additional information about the periodic review of its monetary policy strategy....

Press Release

November 22, 2024

Federal Reserve announces additional information about the periodic review of its monetary policy strategy, tools, and communications

For release at 1:30 p.m. EST

Share 

The Federal Reserve on Friday announced additional information about the periodic review of its monetary policy strategy, tools, and communications—the framework it uses to pursue its congressionally-assigned goals of maximum employment and price stability.

The review is focused on two specific areas: the Federal Open Market Committee's Statement on Longer-Run Goals and Monetary Policy Strategy, which articulates the Committee's approach to monetary policy; and the Committee's policy communications tools. The Committee's two percent longer-run inflation goal will not be a focus of the review.

"We are open to new ideas and critical feedback and will take onboard lessons from the last five years and adapt our approach where appropriate to best serve the American people, to whom we are accountable," said Federal Reserve Chair Jerome H. Powell.

Like the review that concluded in 2020, the upcoming review will include outreach and public events with a wide range of parties. As part of the outreach effort, the Federal Reserve Board will host a research conference on May 15-16, 2025, with speakers and panelists from outside the Federal Reserve System.

The Federal Reserve will continue to host *Fed Listens* public events around the country, and discussions among Federal Reserve policymakers will begin with the January 28-29, 2025, FOMC meeting.

At the end of the process, policymakers will assess the information and perspectives gathered during the review and report their findings. The Fed's first review began in 2019 and concluded in summer 2020.

For media inquiries, please e-mail media@frb.gov or call (202) 452-2955.

Last Update: November 22, 2024

Syllabus and Course Logistics

Structure of the Course

The course will be divided into three parts:

1. Traditional monetary theory and 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: five of them, worth 20 percent of course grade (4 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)

Midterms:

- ▶ February 19 (20 percent of course grade)
- ▶ April 2 (20 percent of course grade)

Final: May 7, 10:30-12:30 (20 percent of course grade)

About Me

Professor and Department Chair, Dept. of Economics

- ▶ B.A. Trinity University, 2003
 - ▶ “Miracle in Mississippi” October 27, 2007
- ▶ Ph.D. University of Michigan, 2009
 - ▶ Don't get the wrong picture
 - ▶ Wife proud ND graduate – Lewis chicken
 - ▶ Signed Charlie Weis picture in office (oops?)

Out of Style I



Out of Style II



In Style



Family



Fun

