

Revised 7 January 2008
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## Economics 172b Money and Banking Spring 2008

### Professor Stephen G. Cecchetti

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### The Goals of the Course:

The purpose of this course is to make students conversant in the language of financial markets and institutions, including providing an understanding of: (1) what money is and why we use it; (2) the fundamental concepts of a financial instrument, including bonds, stocks, and foreign exchange; (3) the basic purpose of financial markets, including stock markets; (4) the role of financial institutions in our economy, with a special emphasis on banks; and (5) the importance of central banks and the conduct of monetary policy.

### Readings:

**Required:** Cecchetti, Stephen G. *Money, Banking, and Financial Markets 2<sup>e</sup>*, McGraw-Hill Irwin, 2008.<sup>1</sup>

One major daily newspaper: *The Wall Street Journal*, *The Financial Times*, or *The New York Times*. You are also encouraged to read *The Economist*.

### Class Meetings:

Material in the book I have written, as well as current events will form the core of what is covered in class meetings. The course schedule lists the class meetings that will begin with a discussion of current events, as well as a few questions that you can use to guide your preparation for the meeting. Students are expected to participate in the discussion.

The current events you should follow should be focused on financial instruments (primarily bonds and stocks); financial institutions (banks, insurance companies, pension funds, and the like); financial markets (like the NYSE Euronext); central banks (the Fed, the ECB, the Bank of Japan); as well as financial regulation and supervision.

Powerpoint slides for the class meetings will be available on the course WebCT site. These slides are **not** substitutes for coming to class. They are simply outlines of the material that I will cover.

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<sup>1</sup> Since I have written the book used in this course, all royalties I obtain from the sale of new copies of my book at the Brandeis University bookstore will be donated to the Department of Economics at Brandeis.

**Evaluation:**

9 Problem Sets:	20%
Class Participation:	10%
2 Midterm:	30%
Final Exam:	40%

Problem Sets: Problems for 7 of 9 problem sets are on the final page of the syllabus. Problem sets are due in class, and **no late problem sets will be accepted!!** (I will drop the lowest problem set score.)

Class participation is scored as 0 or 1. To obtain a 1 you must speak once during a discussion of current events at any time during the semester.

Midterm Examinations: In class on February 13 and March 26. These cover material as noted in the syllabus. The examinations will have 3 sections: (1) Definitions, (2) Short answers, and (3) Long answer problems. Samples will be posted on the course website.

There are no makeup midterm exams. If you miss a midterm examination for any reason, the weight on your final examination will be increased accordingly.

Final Examination: There will be a comprehensive final examination on May 6 held during the time scheduled by the registrar. The final examination will cover all of the material in the class and be of the same structure as the midterms, but longer. If your final exam score is better than your midterm scores, I will take this into account in the final grade.

Examination Grading Policy: Within 24 hours of having an examination returned, you may request that your entire examination be re-graded.

**Grade Distribution:**

The approximate grade distribution will be 40% A's, 40% B's, and 20% lower.

## **Academic Integrity:**

### **The University has request that course syllabi include the following passages:**

“Academic integrity is central to the mission of educational excellence at Brandeis University. Each student is expected to turn in work completed independently, except when assignments specifically authorize collaborative effort. It is not acceptable to use the words or ideas of another person – be it a world-class philosopher or your lab partner – without proper acknowledgement of the source. This means that you must use footnotes and quotation marks to indicate the source of any phrases, sentences, paragraphs or ideas found in published volumes, on the internet or created by another student.

“Violations of University policies on academic integrity, described in Section Three of the *Rights and Responsibilities*, may result in failure in the course or on the assignment, or in suspension from the University. If you are in doubt about the instructions for any assignment in this course, it is your responsibility to ask for clarification.

“If you are working in groups that I have authorized, I will expect your answers to resemble those of your partners; otherwise I expect you to do your work separately from your friends, classmates, family members, and so on. You are not permitted to have anyone other than your professors help you on written assignments outside of class. If you have questions on the type of help you may receive, please ask me before you seek help from someone.”<sup>2</sup>

## **Disabilities:**

If you are a student with a documented disability on record at Brandeis University and wish to have a reasonable accommodation made for you in this class, please see me immediately.

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<sup>2</sup> Shawn McGuirk, Kara Curcio, and Carrie Klugman, “Information for your Syllabi,” Memorandum to Faculty, Department of Student Development and Conduct, Brandeis University, August 1, 2004.

## Tentative Course Schedule

1.	January 16	Introduction and Money: Chapters 1 & 2
2.	January 23	The Financial System: Chapter 3
3.	January 28	Risk: Chapter 5 (PS#1 due)
4.	January 30	Present Value & Bonds: Chapter 4 & 6
5.	February 4	The Risk & Term Structure of Interest Rates: Chapter 7 (PS#2 due)
6.	February 6	Stocks: Chapter 8
7.	February 11	Exchange Rates: Chapter 10
8.	<b>February 13</b>	<b>Midterm Examination #1</b>
<i>February 18 to 22: Winter Break</i>		
9.	February 25	The Economics of Financial Intermediation: Chapter 11
10.	February 27	Banks and Bank Management: Chapter 12
11.	March 3	Financial Industry Structure: Chapter 13 (PS#3 due)
12.	March 5	Financial Regulation: Chapter 14
13.	March 10	Central Banks: Chapter 15 (PS#4 due)
14.	March 12	The Fed and the ECB: Chapter 16
15.	March 17	The Central Bank's Balance Sheet: Chapter 17 (PS#5 due)
16.	March 19	Interest Rate Policy: Chapter 18
17.	March 24	Exchange Rate Policy: Chapter 19 (PS #6 due)
18.	<b>March 26</b>	<b>Midterm Examination #2</b>
19.	March 31	Money Growth, Money Demand, & Monetary Policy Chapter 20
20.	April 2	Federal Reserve Policy
21.	April 7	European Central Bank Policy (PS#7 due)
22.	April 9	Aggregate Demand and Aggregate Supply: Chapter 21
23.	April 14	Applying the AS-AD Model I: Chapter 22
24.	April 16	Applying the AS-AD Model II: Chapter 22 (PS#8 due)
<i>April 21 to 25: Spring Break</i>		
25.	April 28	No Class
26.	April 30	Challenges Facing Modern Central Bankers: Chapter 23 (PS#9 due)
	May 5	Final Examination Review (time to be announced)
	<b>May 6</b>	<b>Final Examination, 1:30 to 4:30pm</b> <b>(This is a "K" block class.)</b>

## Tentative Schedule of Class Meetings

1. January 16: Chapter 1 & 2: Introduction and Money

Study Questions:

What financial transactions have you engaged in over the past week?  
How financial transactions have been different 50 years ago?  
What is the future of money?

2. January 23: Chapter 3: Financial Instruments, Markets, and Institutions

*Current Events*

Study Questions:

Why is financial development related to economic development?  
What are the advantages of ECNs? Will they takeover?

3. January 28: Chapter 5: Understanding Risk  
**(Problem Set #1 Due)**

Study Questions:

Should you buy stock in the company you work for?  
How do mortgages increase risk for homeowners?

4. January 30: Chapters 4 & 6: Present Value and Bonds

*Current Events*

Study Questions:

What is the current 3 month Treasury bill rate? The 10 year Treasury bond rate?  
Are bonds with coupons more or less risky than those without?  
Why did the Russian default affect all emerging market bonds?

5. February 4: Chapter 7: The Risk and Term Structure of Interest Rates  
**(Problems Set #2 Due)**

Study Questions:

What is the importance of junk bonds?  
Is there information in the current term structure of interest rates?  
Is there information in the current slope of the Treasury yield curve?

6. February 6: Chapter 8: Stocks and Stock Markets

*Current Events*

Study Questions:

What is the rationale for advising people to invest in stock index funds?  
How can market participants eliminate bubbles in stock prices?  
Can they do the same with housing prices?

7. February 11: Chapter 10: Exchange Rates

Study Questions:

- What is the current dollar/euro exchange rate?
- Why do you learn from the Big Mac index?
- If investors lost confidence in the US what would happen to the dollar's value?

8. **February 13: Midterm #1** (Chapters 1 through 8, and 10)

February 18 and 22: Winter Break, No Classes

9. February 25; Chapter 11: The Economics of Financial Intermediation

*Current Events*

Study Questions:

- What accounts for the declining importance of bank loans?
- How does deflation affect financing?

10. February 27: Chapter 12: Depository Institutions: Banks and Bank Management

Study Questions:

- How do banks earn their profits?
- How much leveraged are banks? Why?
- What are the primary sources of risks banks face?

11. March 3: Chapter 13: Financial Industry Structure  
**(Problem Set #3 Due)**

*Current Events*

Study Questions:

- Why are there so many banks in the United States?
- What are *eurodollars* and why were they created?
- Why are insurance companies and pension funds complementary?

12. March 5: Chapter 14: Financial Regulation

*Current Events*

Study Questions:

- Do we need the government safety net?
- What are the biggest challenges facing financial regulators today?

13. March 10: Chapter 15: Central Banks  
(**Problem Set #4 Due**)

Study Questions:

What do central banks do? Do we really need them?

What is the relationship between monetary and fiscal policy?

14. March 12: Chapter 16: The Fed and the ECB

*Current Events*

Study Questions:

Read the most recent FOMC statement and think about what it says.

What are the relative strengths and weaknesses of the Fed and the ECB?

If you were to redesign the Fed today, what would you change?

15. March 17: Chapter 17: The Central Bank's Balance Sheet  
(**Problem Set #5 Due**)

Study Questions:

How does an open market operation work?

How does a foreign exchange intervention work?

What are the differences between the two?

Can the central bank control the quantity of money in the economy?

16. March 19: Chapter 18: Interest Rate Policy

*Current Events*

Study Questions:

Why does the Fed choose to control interest rates?

Are there any differences between Fed and ECB operational policy?

What is inflation targeting?

17. March 24: Chapter 19: Exchange Rate Policy

Study Questions:

How are exchange rates and interest rates linked?

Why do some countries choose to fix their exchange rates?

Why do some countries give up their own currency and adopt dollars or euros?

Why are US companies upset about China's fixed exchange rate? Should they be?

(**Problem Set #6 Due**)

18. **March 26: Midterm #2** (Chapters 11 through 19)

19. March 31: Chapter 20: Money Growth, Money Demand, and Monetary Policy

*Current Events*

Study Questions:

Why, when it is high is inflation higher than money growth?  
What are the arguments for and against targeting a monetary aggregate?  
What is the ECB's reference value for money growth? Does it make sense?

20. April 2: Discussion of Federal Reserve Policy  
(Readings to be distributed)

21. April 7: Discussion of European Central Bank Policy  
**(Problem Set #7 Due)**

22. April 9: Chapter 21: Aggregate Demand and Aggregate Supply (new version)

Study Questions:

What is the monetary policy reaction curve?  
How do interest rate movements influence growth and inflation?  
What is the Short-Run Aggregate Supply curve and why does it slope up?  
How does the economy's self-correcting mechanism work?

23. April 14: Chapter 22: Applying the AS/AD Model I  
**(Problem Set #8 Due)**

*Current Events*

Study Questions:

How does stabilization policy work?  
What are the relative merits of fiscal and monetary policy?  
How can you tell the difference between a recessionary gap and  
a fall in potential GDP?

24. April 16: Chapter 22: Applying the AS/AD Model II

*Current Events*

Study Questions:

How can you tell the difference between a recessionary gap and  
a fall in potential GDP?  
Has recent Federal Reserve policy been successful in stabilizing the economy?  
What is the output-inflation volatility tradeoff?

25. April 28: No Class

26. April 30: Chapter 23: Challenges Facing Modern Central Bankers  
**(Problem Set #9 Due)**

Study Questions:

What are the biggest challenges facing monetary policymakers  
over the next decade?

Monday May 5: Final Exam Review Session (time and place to be determined)

**FINAL EXAMINATION TUESDAY MAY 6 1:30-4:30**

## **Problem Sets**

Note: All problems are from the second edition of the textbook.

- #1. (Due January 28): Chapter 1: Problems 5, 17, 18  
Chapter 2: Problems 4, 10, 17  
Chapter 3: Problems 3, 6, 11, 15
- #2. (Due February 4): Chapter 4: Problems 6, 10, 14  
Chapter 5: Problems 4, 11, 17, 18  
Chapter 6: Problems 6, 8, 14
- #3. (Due March 3): Chapter 7: Problems 4, 8, 10, 14, 18  
Chapter 8: Problems 2, 4, 7, 11, 12
- #4. (Due March 10): Chapter 11: Problems 1, 3, 4, 9, 16  
Chapter 12: Problems 5, 10, 11, 16, 18
- #5. (Due March 17): Chapter 13: Problems 5, 9, 13, 16, 17  
Chapter 14: Problems 5, 8, 10, 14, 16
- #6. (Due March 24): Chapter 15: Problems 2, 6, 13, 14, 16  
Chapter 16: Problems 2, 7, 10
- #7. (Due April 7): To Be Announced
- #8. (Due April 16): Chapter 21: Problems 8, 9, 10, 12, 15  
Chapter 22: Problems 7, 10, 11, 13, 14
- 9. (Due April 30): To Be Announced