

## ECONOMICS 235A: MONETARY THEORY

Instructor: Kevin D. Salyer

Office Hours: Monday, 3-5PM or walk-in.

Suggested Text: *Monetary Theory and Policy*, 3<sup>rd</sup> ed. by Carl Walsh.

Course Description and Requirements: The course will consist of a survey of general equilibrium monetary models and their application to issues in monetary theory. Grading will be based upon performance of class presentations, homework and a short paper. The articles denoted by a (\*) are required reading; most are available on the class web site. We will be using Matlab and Dynare to numerically solve some of the models. You should download Dynare from the website (find via Google) and install this on your machine; it will be available in the Department's computer lab.

Note: In addition to the readings below, I will also distribute a set of articles that will be used for class presentations (by you). I will have this list ready by the second week of class.

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### Reading List

#### **I. Issues in Monetary Theory - Generating a Demand for Money**

1. (\*) Sargent, T.J. *Dynamic Macroeconomic Theory*, p. 133 - 140.
2. Hahn, F.H., "On Some Problems of Proving the Existence of an Equilibrium in a Monetary Economy," from *The Theory of Interest Rates*, 1966, Macmillan.

**\*\*\* Read Chapters 2 and 3 in Walsh \*\*\***

#### **II. STATIONARY EQUILIBRIUM AND BUBBLES**

3. (\*) Brock, W.A., "A Simple Perfect Foresight Monetary Model," *Journal of Monetary Economics* (1975), 133-150.
4. Obstfeld, M. and K. Rogoff, "Speculative Hyperinflations in Maximizing Models: Can We Rule Them Out," *JPE* (1983), 675-687.
5. Obstfeld, M. and K. Rogoff, "Ruling Out Divergent Speculative Bubbles," *JME* (1986), 349-362.

#### **III. THE WELFARE COSTS OF INFLATION**

6. Bailey, M.J., "The Welfare Costs of Inflationary Finance," *JPE* (1956), 93-110.
7. Friedman, M. "The Optimum Quantity of Money," in *The Optimum Quantity of Money and Other Essays* (1969), Chicago: Aldine.
8. (\*) Lucas, R.E., Jr., "On the Welfare Costs of Inflation," *Econometrica* (2000), 247-274.

#### **IV. STATIONARY EQUILIBRIUM IN STOCHASTIC SETTINGS - DYNAMIC NEUTRALITY**

##### MIUF models

9. (\*) LeRoy, S.F., "Nominal Prices and Interest Rates in General Equilibrium: Money and Endowment Shocks," *Journal of Business* (1984), 177-213.

10. Danthine, J-P. , and J.B. Donaldson, "Inflation and Asset Prices in an Exchange Economy," *Econometrica*, (1986), 585-605.

#### CIA models

11. (\*) Lucas, R.E., Jr., "Interest Rates and Currency Prices in a Two-Country World," *JME* (1982), 325-359.
12. (\*) Svensson, L.E.O., "Money and Asset Prices in a Cash-in-Advance Economy," *JPE* (1985), 927-944.
13. (\*) Salyer, K.D., "Exchange Rate Volatility: The Role of Real Shocks and the Velocity of Money," *Economic Inquiry* (1988), 387-409.
14. (\*) Salyer, K.D., "The Timing of Markets and Monetary Transfers in Cash-in-Advance Economies," *Economic Inquiry* (1991), 762-773.

#### **V. THE FISHER RELATION, THE TERM STRUCTURE OF INTEREST RATES, AND ASSET PRICING**

15. (\*) Piazzesi, M. and M. Schneider, "Equilibrium Yield Curves," 2006, NBER Working Paper 12609.
16. (\*) Backus, D.K., A.W. Gregory, S.E. Zin, "Risk Premiums in the Term Structure: Evidence from Artificial Economies," *JME* (1989), 371-399.
17. (\*) Salyer, K.D., "The Term Structure and Time Series Properties of Nominal Interest Rates: Implications from Theory," *JMCB* (1990), 478-490.
18. Rudebusch, G. and E. Swanson, "Examining the bond premium puzzle with a DSGE model", *Journal of Monetary Economics* 2008, S111-S126 (Supplemental October Volume).
19. (\*) Rudebusch, G. and E. Swanson, "The Bond Premium in a DSGE model with Long Run Real and Nominal Risks," 2009, SF Fed working paper.

#### **VI. SOLVING DSGE MODELS USING LINEARIZATION**

20. (\*) Handout, A User's Guide to Solving Real Business Cycle Models.
21. (\*) Collard, Notes.

#### **VII. MONEY AND PRODUCTION – THE ROLE OF THE INFLATION TAX**

22. (\*) Cooley, T.F. and G.D. Hansen, "The Inflation Tax in a Real Business Cycle Model," *AER* (1989), 733-48.
23. (\*) Salyer, K.D., "Interpreting a Monetary Equilibrium as a Modified Social Planner Problem," *Journal of Economic Dynamics and Control* (1996), 681-689.

#### **VIII. MODELING THE LIQUIDITY EFFECT OF MONEY**

24. Fuerst, T.S., "Liquidity, Loanable Funds, and Real Activity," *Journal of Monetary Economics* (1992), 3 - 25.
25. (\*) Christiano, L.J., M. Eichenbaum, C.L. Evans, "Sticky Prices and Limited Participation Models: A Comparison," *European Economic Review*, (1997), 1201-1249.

26. (\*) Christiano, L.J., M. Eichenbaum, C.L. Evans, “Nominal Rigidities and the Dynamic Effects of a Shock to Monetary Policy,” *JPE*, 2005, 1-45.
27. (\*) Jordá, O. and K.D. Salyer, “The Response of Term Rates to Monetary Policy Uncertainty,” *Review of Economic Dynamics* 6 (2003), 941-962.

#### **IX. AGENCY COSTS AND FINANCIAL INTERMEDIATION**

28. Walsh, Chapter 10.
29. (\*) Carlstrom, C. and T. Fuerst, “Agency Costs, Net Worth and Business Fluctuations: A Computable General Equilibrium Analysis,” *AER* (1997), 893-910.
30. (\*) Dorofeenko, V., G. Lee, and K. Salyer, “Time Varying Uncertainty and the Credit Channel,” *Bulletin of Economics Research* (2008), 375-403.
31. Bernanke, B., M. Gertler, and S. Gilchrist, “The Financial Accelerator in a Quantitative Business Cycle Framework,” in *Handbook of Macroeconomics 1C*, Elsevier: 2000.
32. Carlstrom, C. and T. Fuerst, “Monetary Shocks, Agency Costs, and Business Cycles,” *Carnegie-Rochester Conference Series on Public Policy*, June 2001, vol. 54, no. 1, pp. 1-27.
33. Dorofeenko, V., G. Lee, and K. Salyer, “Risk Shocks and Housing Supply: A Quantitative Analysis,” UC Davis Working Paper, 2012.
34. Christiano, L., R. Motto, M. Rostagno, “The Great Depression and the Friedman-Schwartz Hypothesis,” NBER Working Paper, 2004.
35. Christiano, L., R. Motto, M. Rostagno, “Financial Factors in Business Cycles,” Working Paper, 2007.
36. Gilchrist, S., J. Sim and E. Zakrajsek, “Uncertainty, Credit Spreads, and Investment Dynamics,” 2009, Federal Reserve Working Paper.

#### **XI. MONETARY POLICY**

37. (\*) Walsh, Chapter 8.
38. Christiano, Trabandt, and Wallentin, DSGE Models for Monetary Policy Analysis, *Handbook of Monetary Economics*, 2011.
39. Gali, J., “New Perspectives on Monetary Policy, Inflation, and the Business Cycle,” NBER Working Paper 8767, February 2002.
40. (\*) Smets, Frank, and Rafael Wouters, “Shocks and Frictions in US Business Cycles: A Bayesian DSGE Approach.” *American Economic Review* (2007): 586—606.
41. (\*) Chari, V.V, P. Kehoe, and E. McGrattan, “New Keynesian Models: Not Yet Useful for Policy Analysis,” NBER Working Paper 14313, 2008.

## **XII. Financial Crises and More**

42. Diamond, D. W. and P. H. Dybvig. "Bank runs, deposit insurance, and liquidity." *Journal of Political Economy*, 91(3):401–419, June 1983.
43. Holmstrom B. and J. Tirole. "Financial intermediation, loanable funds, and the real sector." *Quarterly Journal of Economics*, 112(3):663–691, 1997.
44. Gorton G., B. Holmström, and T. V. Dang. "Ignorance and the optimality of debt for the provision of liquidity," 2009. Yale University working paper.
45. Uhlig, H.. "A model of a systemic bank run." *Journal of Monetary Economics*, 57(1):78 –96, 2010.
46. Brunnermeier, M.K. and L. H. Pedersen. "Market liquidity and funding liquidity." *Review of Financial Studies*, 22(6):2201–2238, 2009. -
47. Vayanos, D. and J. Wang, "Market Liquidity - Theory and Empirical Evidence," forthcoming 2012, *Handbook of Economics and Finance*.
48. Vayanos, D. and J-L. Vila, "A Preferred-Habitat Model of the Term Structure of Interest Rates," 2009, Working Paper.
49. Lorenzoni, G.. Inefficient credit booms. *Review of Economic Studies*, 75(3):809–833, 07, 2008.
50. Gorton, G., "Some Reflections on the Financial Crisis," NBER Working Paper 18397, 2012.