UNIVERSITY OF LONDON

Course information 2024-25

EC3115 Monetary Economics

General information

MODULE LEVEL: 6

CREDIT: 30

NOTIONAL STUDY TIME: 300 hours

MODE: Locally Taught, Independent Learner Route and Online Taught

Summary

This course introduces the concept of money; what it is, why we use it and how it is created. It examines monetary policy in a closed economy, considering several models that allow real effects of monetary policy, ranging from new-Classical to Keynesian. Specific models will be introduced and solved, allowing students to see exactly how these models work and what differentiates one from another. It then studies Dynamic Stochastic General Equilibrium Models which brings together insights from Real Business Cycle Models and Keynesian macroeconomics. Finally, it studies uncertainty in monetary economics that is pervasive in macroeconomic modelling and takes the form of data, parameter and model uncertainty and introduces students to the concept of robust monetary policy design.

Conditions

Please refer to the relevant programme structure in the EMFSS Programme Regulations to check:

- where this course can be placed on your degree structure; and
- details of prerequisites and corequisites for this course.

You should also refer to the Exclusions list in the EMFSS Programme Regulations to check if any exclusions apply for this course.

Aims and objectives

The aims of the course are to:

- Develop understanding of the theories that relate to the existence of money, explaining why it is demanded by individuals and used in the trading process.
- Develop an understanding of the monetary transmission mechanism, whereby decisions made by the monetary authorities concerning money supply or interest rates can have real effects on the economy.

- Develop a number of macroeconomic models through which monetary policy can be evaluated. Such models will include both Classical and Keynesian schools of thought and will consider why monetary policy matters and when monetary policy decisions may be impotent.
- Develop understanding of the uncertainties policy-makers face and how policy makers may deal with these.

Learning outcomes

At the end of this course and having completed the essential reading and activities students should be able to:

- Explain and discuss why people hold money and why it is used in the trading process.
- Solve macroeconomic models and assess the role and efficacy of monetary policy for various types of models.
- Describe and explain the main channels of the monetary transmission mechanism, through which monetary policy can have real effects on the economy.
- Discuss the merits and disadvantages of different monetary policies used by Central Banks.
- Introduce the concepts of data and parameter uncertainty and discuss the policy under uncertainty.

Employability skills

Below are the three most relevant employability skills that students acquire by undertaking this course which can be conveyed to future prospective employers:

1. Complex problem solving
2. Decision making
3. Creativity and innovation

Essential reading

For sections 1 and 2 of this course, students are encouraged to buy:

Either Lewis, M.K. and P.D. Mizen Monetary Economics. (Oxford; New York: Oxford University Press, 1995) first edition [ISBN 978-0198290629]

OR

Carlin, W. and D. Soskice Macroeconomics: Imperfections, Institutions and Policies. (Oxford: Oxford University Press, 2014) [ISBN 978-0199655793]

Throughout the course, students will be required to read several articles. These are primarily taken from the following journals: Journal of Monetary Economics, American Economic Review; Journal of Political Economy; Quarterly Journal of Economics; Review of Economics and Statistics; Review of Economic Studies, Economic Inquiry.

Assessment

This course is assessed by a three-hour and fifteen-minute closed-book written examination.

Syllabus

The nature of money: What constitutes money. Why people hold money; introduction to cash in advance (CIA) and money in the utility (MIU) functions.

Money demand and supply: Microeconomic determinants of the demand for money and macroeconomic money demand functions. Financial intermediaries, banks, and money creation.

The Classical school, neutrality of money and the quantity theory: The Classical dichotomy, Walras' and Say's laws, introduction to money in a general equilibrium setting.

The welfare effects of inflation and monetary policy: Neutrality and super neutrality of money, welfare costs, seignior age and the inflation tax.
The Keynesian approach to monetary policy — nominal rigidities: Multi-period pricing and the persistence of monetary policy shocks. The Lucas critique.

Interest rates and inflation in the New Keynesian model: Nominal rigidity and Calvo price setting, the New Keynesian Phillips curve, aggregate demand and interest rates, the natural rate of interest, the Taylor rule, objectives of monetary policy, inflation targeting.

Term structure of interest rates: Explanation of the yield curve: expectations hypothesis and the segmentation hypothesis.

The transmission mechanism of monetary policy: Asymmetric information in credit markets, balance sheets and the costs of internal and external finance, collateral constraints and asset prices, the financial accelerator.

Time inconsistency in monetary policy: Inflation bias, the central bank independence. Monetary policy rules: interest rate targeting and monetary targeting. (Rules versus discretion).

Conventional and unconventional monetary policy: optimal monetary policy, cost-push shocks and flexible inflation targeting, the lower bound on nominal interest rates, quantitative easing and the liquidity trap, forward guidance, quantitative easing and the portfolio balance effect, negative nominal interest rates.

Uncertainties in monetary policy design: News versus noise in data revisions, Brainard conservatism, certainty equivalence, interest rate smoothing.