SYLLABUS

Course Description

Financial systems and central banks are often in the news as countries cope with economic problems and crises. This course is an MBA elective that examines financial systems (institutions, instruments, markets, practices, and public authorities) from the perspectives of both financial and economic stability. The course provides an overview of how monetary policy interacts with financial markets. The class aims to answer the following questions:

- How is a financial system organized? What purposes does it serve?
- How and why may the financial system be vulnerable?
- Why and how do countries regulate the financial sector?
- What do central banks do? How do they do it? What are their key challenges?
- How is monetary policy conducted?
- How is monetary policy transmitted to the economy?

The course consists of two parts:

1. **The Financial System and Regulation**: This part studies how financial institutions and instruments help market participants share risk, how the financial system can became unstable during the financial crisis of 2007-2009.

2. **Monetary Policy**: This part explains the how monetary policy is conducted, how it helps to stabilize the economy by trading off real activity and inflation, as well as exchange rate policy.

Schedule

The class meets on Saturdays, 9am-12noon in room KMC 2-80.
Readings


Slides and additional material (handouts, articles, papers, data...) will be available on NYU Classes, which is also the source of all administrative announcements regarding the course.

Classes will frequently begin with a discussion of current events related to the theme(s) of the week. Regularly reading news sources such as the Financial Times, The Wall Street Journal and The Economist will greatly facilitate the debate. The class will also frequently draw on material from the New York Fed’s Liberty Street Economics blog Liberty Street Economics Blog, other economic and financial blogs, and market commentary.

Grading

The final grade will be a weighted average of the following deliverables:

- **Class participation (10%)**. Your grade will take into account both the frequency and the quality of your contributions. Attendance, punctuality and your overall citizenship in class will matter as per the “Default policies for Stern courses”.

- **Problem sets (25%)**. The problem sets are designed to solidify the background reading, and apply principles and tools developed in class. Each week problem sets are due until the week before the exam (six problem sets in total). I will post the problem sets on NYU Classes starting from week 2. You will have one week to hand in the solutions, which are due at the beginning of each class. The best five problem sets will count toward your final grade. Problem sets are the best preparation for the exam. Feel free to work on problem sets alone or in groups but each student should submit her/his own answers.

- **Exam (40%)**. A two-hour final is scheduled for the 9th week of class. The exam is closed book but a calculator is allowed. Students are responsible for avoiding any conflicts between the exam date and other commitments. The only acceptable exceptions are listed in “Default policies for Stern courses”.

- **Final paper and presentation (25%)**. Groups of three people (max) work on a paper (5-page max---figures, tables and references excluded) that investigates details of an aspect of recent developments in monetary policy, financial markets, or financial institutions. Each group gives a presentation (15 minutes max) in one of the last two classes. All members of each group should contribute equally to the paper and the presentation. All students are expected to participate in the discussion of each presentation.
The detailed course outline provides dates and deadlines for all assignments. Questions about grading must be made in writing (send me an email and give me the exam with a written note describing the disagreement), no more than a week after the exams are returned.

**Assistance & Communication**

Email is the best way to get a quick answer from me. For longer discussions, I can meet after the classes on Saturdays. Students can always email me to set up alternative times. Ashish Mehta, the teaching assistant, can also help with questions. Email him for quick answers or to set up a mutually convenient time to meet.

**Students with disabilities**

Students with a qualified disability, who require academic accommodation during this course, should contact the Moses Center for Students with Disabilities (CSD, 998-4980) and provide me with a letter from the Center verifying your registration and outlining the recommended accommodations. Students who need to take an exam at the CSD must submit a completed Exam Accommodations Form to the Center at least one week prior to the scheduled exam time to be guaranteed proper accommodation.

**Honor Code**

The Stern community believes that honesty and integrity are necessary for rewarding academic and professional experiences. These qualities form the basis for the strong trust among members of the academic community (students, faculty, and administrators) that is essential for excellence in education. The Honor Code requires that each student act with integrity in all academic activities and endeavor to hold her/his peers to the same standard.
Outline and Calendar (Fall 2014)

Part 1: The Financial System and Regulation

Class 1: September 20, 2014, Introduction and Term Structure of Interest Rates
- Reading: Chapters 1-3, 7, FOMC Statement from September 17, The Recent Bond Market Selloff in Historical Perspective
- Questions:
  - Why is financial development related to economic development?
  - How and why are financial institutions evolving?
  - The information content of the term structure of interest rates
- Problem set 1 distributed

Class 2: September 27, 2014, Economics of Financial Intermediation
- Reading: Chapters 11, 12, Shadow Banking, The Changing Nature of Financial Intermediation and the Financial Crisis of 2007-09
- Questions:
  - How do financial institutions earn profit?
  - What accounts for shifts between bank finance and other types of finance?
  - What is shadow banking?
- Problem set 1 due, problem set 2 distributed

October 4, 2014: No class (Yom Kippur)

Class 3: October 11, 2014, Financial Industry Structure
- Reading: Chapters 13, 14, September FOMC Minutes
- Questions:
  - Why are there so many banks in the United States?
  - What is the lender of last resort?
  - Do we need the government safety net? What is its impact?
- Problem set 2 due, problem set 3 distributed

Class 4: October 18, 2014, Regulation
- Further reading: Davis-Polk Dodd-Frank Resource Center
- Questions:
  - What is systemic risk and how can regulators address it?
  - What are the differences between micro- and macro-prudential regulations?
  - How will recent financial crises affect regulation going forward?
- Problem set 3 due
- Form groups and choose topics for paper/presentations
Class 5: October 25, 2014, The Financial Crisis of 2007-09 and Lending of Last Resort

- Reading: Ben Bernanke Statement Before the Financial Crisis Commission, Money, Liquidity, and Monetary Policy, The Federal Reserve’s Commercial Paper Funding Facility, The Federal Reserve’s Primary Dealer Credit Facility
- Further reading: Financial Crisis Timeline, December 2007 FOMC Transcripts & Exhibits
- Questions:
  - What caused the crisis? Why was it so broad, deep and prolonged?
  - What role did the lender of last resort play?
  - How to distinguish between illiquidity and insolvency?
  - What are impacts of the Dodd-Frank act?
- One page outline of paper/presentation due
- Problem set 4 distributed (practice exam)

Part 2: Monetary Policy

Class 6: November 1, 2014, Central Banks in the World Today

- Reading: Chapters 15, 16, October FOMC Statement, Economic Projections
- Questions:
  - What do central banks do? Do we need them?
  - How do monetary and fiscal policies differ?
  - How are the Fed and the ECB similar? How are they different?
- Problem set 4 due, problem set 5 distributed

Class 7: November 8, 2014, The Central Bank Balance Sheet and Money-Supply

- Reading: Chapter 17, 18 Why are Banks Holding so Many Excess Reserves?, Divorcing Money from Monetary Policy
- Questions:
  - How does an open-market operation work?
  - How does a foreign exchange intervention work?
  - Can the central bank control the quantity of money in the economy?
- Problem set 5 due, problem set 6 distributed

Class 8: November 15, 2014: Monetary Policy Stabilization

- Reading: Chapters 20, 21, 22
- Questions:
  - What are the goals of monetary policy?
  - Why do central banks usually choose to control interest rates?
  - How do price, inflation and nominal GDP targeting differ? How do they work?
- Problem set 6 due, problem set 7 distributed

Class 9: November 22, 2014

- Exam (two hours)
November 29, 2014: No class (Thanksgiving)

Class 10: December 6, 2014, Financial Stability Monitoring and Macroprudential Policy
  • Reading: FSOC 2013 Annual Report, OFR 2013 Annual Report, Financial Stability Monitoring, Shadow Bank Monitoring, Selection and Application of Macroprudential Instruments
  • Questions:
    o What is the monitoring framework for financial stability since the crisis?
    o What are appropriate policy measures if imbalances emerge?
  • Papers due

Class 11: December 13, 2014, Presentations and outside speaker
  • Outside speaker (TBD)
  • First set of presentations (15 minutes each group)

Class 12: December 20, 2014, Paper presentations
  • Remaining presentations (15 minutes each group)

Additional Reading (optional):
  • Decomposing Real and Nominal Yield Curves
  • Understanding the Securitization of Subprime Mortgage Credit
  • Aggregate Supply in the United States: Recent Developments and Implications for the Conduct of Monetary Policy
  • The Federal Reserve’s Framework for Monetary Policy–Recent Changes and New Questions