

COLUMBIA UNIVERSITY
GRADUATE SCHOOL OF BUSINESS

FINANCIAL MARKETS AND THE ECONOMY
B8351

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GENERAL DESCRIPTION

This is a lecture course that is intended to help you understand the role that financial markets play in the business environment that you will face in the future. It also provides an understanding of the underlying institutions that either help financial markets work well or that interfere with the efficient performance of these markets. This course develops a series of applications of principles from finance and economics that explore the connection between financial markets and the economy. In addition, it will focus on many public policy issues and examine how the most important players in financial markets, central banks, operate and how monetary policy is conducted. The course will have a strong international orientation by examining monetary policy in many countries and possible reforms of the international financial system. We will also focus on current events reported in the financial press by starting each class with an extensive class discussion of what has recently appeared in the *Wall Street Journal* and will use the analytic frameworks developed in class help us to understand these developments.

REQUIRED TEXTS

(M) Mishkin, F.S., *The Economics of Money, Banking and Financial Markets*, Seventh Edition (Addison-Wesley: Reading, Mass. 2004). Available from the university bookstore.

(C) Casebook

OPTIONAL READINGS

A good source of current readings on money and financial markets is:

(EM) Eaton, J.W. and F.S. Mishkin, *2004 Readings to Accompany the Economics of Money, Banking, and Financial Markets*. Available free on the internet if you bought a new textbook. Access via www.aw.com/mishkin, then click "Student Resources" and then the reader box (which will then require you to log in). Note that this website has other information and related links that you might find of interest.

EXAMS, PROBLEM SETS AND CLASS PARTICIPATION

The course will have a final and it will count toward 80% of the final grade. There will be 8 problem sets, to be completed individually, which will be graded and count toward 20% of the final grade. (There is one additional problem set which is semi-optional: the material covered in the problem set will be covered in the final, but the problem set is not to be handed in and will not be graded.) Class participation will not be graded and is strictly voluntary but essential.

OFFICE HOURS

Official office hours are Monday and Wednesday, immediately after class or from 3-5. (An e-mail to let me know if you are coming at a particular time is highly recommended.) I am willing to see students at other times that are more convenient for them as long as an appointment is made via e-mail.

TEACHING ASSISTANT

The teaching assistant for the course is Pritha Mitra. She will conduct problem set review sessions after every two problem sets. She is available for any help you may need by appointment which can be made by email. Her e-mail address is pm353@columbia.edu.

TOPICS AND SPECIFIC READINGS

I. INTRODUCTION AND REVIEW

- (M) Ch. 1 Why Study Money, Banking and Financial Markets
 Ch. 2 An Overview of the Financial System
 Ch. 3 What is Money?
 Ch. 4 Understanding Interest Rates
 Ch. 7 The Stock Market, the Theory of Rational Expectations and the Efficient Markets Hypothesis

Optional:

- (EM) Readings 1-4,7-8.

II. INTEREST RATE BEHAVIOR

- (M) Ch. 5 The Behavior of Interest Rates
 Appendix to Chapter 5 (found on website www.aw.com/mishkin):
 Applying the Asset Market Approach to a Commodity Market: The Case of Gold

Optional:

- (M) Ch. 6 The Risk and Term Structure of Interest Rates
 (EM) Readings 5-6.
 Stigum, M., *The Money Market*, 3rd edition (Homewood, Ill.: Dow Jones-Irwin, 1989).

III. FINANCIAL INSTITUTIONS

- (M) Ch. 8 An Economic Analysis of Financial Structure
- (C) Mishkin, F.S. "Understanding Financial Crises: A Developing Country Perspective," in Michael Bruno and Boris Pleskovic, eds., *Annual World Bank Conference on Development Economics 1996* (World Bank: Washington D.C. 1996): 29-62.
- (M) Ch. 9 The Banking Firm and the Management of Financial Institutions
- Ch. 10 Banking Industry: Structure and Competition
- Ch. 11 Economic Analysis of Banking Regulation
- Ch. 12 Nonbank Finance

Optional:

- (M) Ch. 13 Financial Derivatives
- (EM) Readings 9-32.
World Bank, *Finance for Growth: Policy Choices in a Volatile World* (Oxford University Press: 2001).
Kane, E.J., "Accelerating Inflation, Technological Innovation, and the Decreasing Effectiveness of Banking Regulation," *Journal of Finance* 36 (May 1981): 355-67.

IV. CENTRAL BANKING AND THE MONEY SUPPLY PROCESS

- (M) Ch. 14 Structure of Central Banks and the Federal Reserve System
- (C) Mishkin, F.S., "What Should Central Banks Do?" Federal Reserve Bank of St. Louis *Review*, vol. 82, #6 (November/December 2000): 1-13.
- (M) Ch. 15 Multiple Deposit Creation and the Money Supply Process
- Ch. 16 Determinants of the Money Supply

Optional:

- (EM) Readings 33-34.

V. CONDUCT OF MONETARY POLICY

- (M) Ch. 26 Transmission Mechanisms of Monetary Policy
 Ch. 17 Tools of Monetary Policy
 Ch. 18 Conduct of Monetary Policy: Goals and Targets

Optional:

- (EM) Readings 35-37, 47-49.
 Akhtar, M.A., *Understanding Open Market Operations* (Federal Reserve Bank of New York, 1997)
 Friedman, M., and Schwartz, A.J., *A Monetary History of the United States 1867-1960* (Princeton: Princeton University Press, 1963).

VI. THE INTERNATIONAL FINANCIAL SYSTEM AND POSSIBLE REFORMS

- (M) Ch. 19 The Foreign Exchange Market
 Ch. 20 International Financial System
- (C) Obstfeld, M. and K. Rogoff. "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives* 9 (Fall 1995): 73-96.
- (C) Calvo, Guillermo and F.S. Mishkin, "The Mirage of Exchange Rate Regimes for Emerging Market Countries", *Journal of Economic Perspectives*, forthcoming.
- (C) Mishkin, F.S., "The Dangers of Exchange Rate Pegging in Emerging-Market Countries" *International Finance*, Vol 1, # 1 (October 1998): 81-101.
- (C) Mishkin, F.S., "Lessons From the Asian Crisis", *Journal of International Money and Finance*, 18, 4 (August 1999): 709-723.
- (C) Mishkin, F.S., "The International Lender of Last Resort: What are the Issues?" in Horst Siebert, ed. *The World's New Financial Landscape: Challenges for Economic Policy*, (Springer-Verlag: Berlin, 2001): 291-312.

Optional:

- (EM) Reading 38-41.
 Krugman, Paul R. and Maurice Obstfeld, *International Economics: Theory and Policy*, 6th Edition (New York: Addison-Wesley, 2003)

VII. MONETARY POLICY STRATEGY: THE INTERNATIONAL EXPERIENCE

- (M) Ch. 21 Monetary Policy Strategy: The International Experience
- (C) Mishkin, F.S. and A. Posen, "Inflation Targeting: Lessons from Four Countries," Federal Reserve Bank of New York, *Economic Policy Review*, vol. 3, #3 (August 1997): 9-110.
- (C) Mishkin, F.S., and M. Savastano, "Monetary Strategies for Latin America," *Journal of Development Economics.*, 66, 2 (December 2001): 415-444.

Optional:

- (EM) Readings 42-46.
Bernanke, B., Laubach, T., Mishkin, F.S. and Posen A., *Inflation Targeting: Lessons from the International Experience*, (Princeton: Princeton University Press, 1999).