Policy Decisions by Central Banks: The Fed, the ECB and the BOI

Fall 2018
Professor Zvi Eckstein

FNCE 893/393

August 28, 2018 to October 17, 2018
Office hours: SH-DH room 2461, Tuesday 4:30 – 6:00 pm, by appointment
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Class location: FNCE 393 JMH F94, 9:00-10:20; FNCE 893 JMH F94, 10:30-11:50;

Summary: Understanding and predicting central banking decision making and behavior is crucial for all market participants from asset managers and traders to private consumers. This course aims to provide the methods and knowledge on how central banks and governments think and implement policies to reach the goals of price and financial stability as well as support of growth and employment. The core of the course connects between the legal and actual goals that central banks follow and the related economic analysis on which these goals and policies are set. We explain the economic rationale for the policy prescriptions to reach the goals and how these policies are actually implemented by the Federal Reserve Bank (Fed) in the US, the European Central Bank (ECB), Bank of Israel (BOI) and some remarks on other countries. We use data, current events and events of the 2007-2018 period as the basis for discussion and assignments. All these are aimed understanding how and why the Fed, the ECB and the BOI set their policies. For each we shall simulate in class current decisions based on assignments related to past policies and the theory presented in class. We shall start class with discussion of news items.

Requirements and grading: Final examinations (55% - passing grade is required); two out of three assignments (cases) done by teams of 3-4 students (20%); one group presentation (10%) or extra assignment; active participation in class discussion (15%).

References: We refer to one textbook, papers, books, reports, lectures, news items and analysis that were recently published on each of the topics. These are references that are supportive information but are not required to follow. For the assignments, we provide necessary readings.

Main reference Text:

Optional recommended addition texts to read:
Class 1: Introduction: Financial Crisis and Central Banks actions (August 28)

Readings

Optional Background:
A.B.C., Macroeconomics, pp. 558-563

Class 2&3: Inflation and Interest: Foundations (Aug. 30, Sept. 3)

- Main Question: What is the optimal long run (target) inflation rate?

Readings

Priority:
- B. Bernanke, "How big a problem is the lower zero bound on interest rates?", Blog, April 4, 2017; "The zero lower bound on interest rate: How should the Fed respond?", Blog, April 13, 2017.

Optional Background: A.B.C., Macroeconomics, pp. 255-273; 321-328; 564-568

Optional additional:
1. Mishkin, 9th &10th Ed. Chapters: 13, 14, 15, 19; BS 4th Ed- ch.3, Ch. 19, Ch. 22, Ch. 23.

Assignment 1: Was the Fed federal fund rate too low too long and was it an important cause of the 2007/8 financial crisis? Readings are in the Assignment. Due September 11.

Class 4&5: The Taylor Rule: How do Central Banks conduct monetary policy? (September 5, 11)

Reading (also for Assignment 1):
Priority:


• Optional background: A.B.C., Macroeconomics, pp. 550-559; 568-573.

Optional additional:
1. Mishkin, 9th and 10th Ed. Chapter 16, 23, 24; BS 4th Ed. Ch. 18-19, Ch.25.

• Assignment 2: From the QE to normality: what is the path of Fed policy rate? Due Sept. 18.

• Sept. 11: Discussion and presentations of Assignment 1.

Class 6&7: At the Zero Lower Bound of interest rate (September 13, 18)

• Main question: Can monetary policy be effective at the zero lower bound of interest rate?

• Reading:

Priority:


• Optional: Background: A.B.C., Macroeconomics, p. 549, 550, 559, 610.

• Optional additional:
1. On Secular Stagnation and Fed policy: Read blogs by Larry Summers; Ben Bernanke and Bradford Delong.
2. Mishkin, BS 4th Ed. Ch. 6, Ch. 17 p. 403-408 and Web Appendices.

• September 18: Simulation and discussion of the FOMC decision of 9/26 and Assignment 2.
Class 8&9: Flexible Inflation Targeting Policy: Model and Practice (September 20, 25)

- Main question: What is the theory and practice of modern monetary policy analysis?
- Readings:

  - Priority:
  - Class notes on DSGE model
  - Background readings: A.B.C., Macroeconomics, pp.434, ch.10.4, 10.5, 13.1, 13.4

Optional additional:

- Assignment 3: The ECB monetary policy under Mario Draghi: Does it follow a Taylor Rule or only one goal of “price stability”? What is the impact of negative deposit rate and the ECB QE? Due October 2.

5. Class 10&11: The European Debt Crisis and ECB monetary policy (September 27 and October 2)

- Main Question: How does fiscal and monetary policy affect financial stability?
- Reading
- Priority:
  - Mario Draghi, Speech on July 26, 2012, “Whatever it takes”.
- Background readings: A.B.C., Macroeconomics, p. 518, 594-603, 616

Optional additional:

October 2: Simulation of the next ECB monetary policy decision and assignment 3.

6. Class 12: Small open economy: Bank of Israel monetary policy framework and negative rates of the Swiss and Sweden central banks (October 9).

- Main question: Should monetary policy include exchange rate intervention?
- Priority Reading:

Optional additional:
- Mishkin, 9th and 10th Ed. Chapters 17, 18; BS 4th Ed. Ch. 20-21.

- **Optional Assignment 4**: Why does the Bank of Israel intervene in the forex market and is it consistent with the Bank's objectives? Due at the examination.

7. **Class 13: Guest Lecture: Dr. David Woo**, Managing Director, Head of Global Interest Rates & Currencies Research, Bank of America-Merrill Lynch

- **Global Monetary Policies (October 11)** at 10:30 class.

8. **Class 14. Review of the Fed, The ECB and BOI monetary policy and predictions to the near future (October 16).**

**FINAL Examination:** October 17; 6pm - 8pm.

**Teaching Assistants**

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