

UNIVERSITY OF ESSEX

DEPARTMENT OF ECONOMICS

Session 2005-06

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EC248-2-SP: MONETARY INNOVATIONS AND CENTRAL BANKS

READING LIST AND COURSE OUTLINE

Details of assessment and submission deadlines are contained in the Undergraduate Economics Handbook, available from room 5B.211. Further information about the course is contained in the University's course catalogue, see <http://www2.essex.ac.uk/courses/>, and – in much greater depth – on the specially developed and maintained course website at <http://courses/essex.ac.uk/ec/ec248/>.

Two *essential* readings, complementing each other, are recommended for this course: Mishkin (2004) focuses on money and central banking within the environment of a modern financial system, providing US but also international examples; Howells and Bain (2004), in turn, introduces financial markets and institutions within mostly the UK context. In addition, the use of two older but quite successful books is encouraged as *supplementary* reading on certain topics, as indicated further down: Fraser, Gup and Kolari (2001) – or the newer edition, Gup and Kolari (2004) – takes the view of commercial banks in their role as intermediaries between savers and debtors in the economy; Goodhart (1988), on the other hand, provides a dense historical and functional analysis of the evolution of central banks. Other sources, including book chapters and journal articles, are sometimes suggested as *background* reading on particular aspects of a topic. For those who are strongly interested in the subject matter of the course, specialised journals and websites have been selected from a multitude of relevant ones: these contain articles and documents, often downloadable as pdf files.

Because of the comprehensiveness and complementarity of the two textbooks, no detailed *lecture notes* (or handouts) will be provided for this course. Yet to help students in their preparation, the course outline which follows specifies the precise chapters expected to be read from each source. Moreover, the *presentation slides* to be discussed in class are made available on the course website: they condense the material of each lecture into an essential structure that is easy to remember. As the course proceeds on, updated versions of these slides will be posted in advance of each lecture. Any feedback will be appreciated.

Essential reading

1. Mishkin, Frederic, “The Economics of Money, Banking, and Financial Markets”, Addison-Wesley, 2004 (7th ed.) – presents at an introductory level but in a very comprehensive way the financial system within which modern central banks conduct their monetary policies as well as the role played by commercial banks and other financial-sector intermediaries in both a national and an international perspective; extensive student resources are available on the publisher's website at http://wps.aw.com/aw_mishkin_econmbfm_7.

2. Howells, Peter and Keith Bain, “Financial Markets and Institutions”, Prentice Hall – Financial Times, 2004 (4th ed.) – fulfils objectives similar to those of Mishkin (2004), at the same time benefiting from extreme pedagogical clarity, relative conciseness and pragmatic orientation, in particular on how to read financial pages in the UK institutional context; student resources are available on the publisher's website at http://wps.pearsoned.co.uk/ema_uk_he_howells_finmark_4.

Supplementary reading

1. Fraser, Donald, Benton Gup and James Kolari, South-Western – Thomson Learning, 2001 (2nd ed.), or Gup, Benton and James Kolari, John Wiley & Sons, 2004 (3rd ed.), “Commercial Banking: The Management of Risk” – focuses in a straightforward way on the special role of commercial banks in the economy, presenting their structure and operations with view to the latest banking developments and with a particular emphasis on bank and risk management.
2. Goodhart, Charles, “The Evolution of Central Banks”, MIT Press, 1988 (2nd ed.) – a brief but informative account of the difficult craft of central banking, as it emerged and evolved, by a prominent economic historian and policy advisor in the domain.

Background reading

1. Rose, Peter and Sylvia Hudgins, “Bank Management & Financial Services”, McGraw-Hill/Irwin, 2005 (6th international ed.) – a broad introductory textbook on banking with an up-to-date coverage of nonbank financial services providers and related innovations.
2. Blinder, Alan, “Central Banking in Theory and Practice (Lionel Robbins Lectures)”, MIT Press, 1998 – also available on the shelves of the Albert Sloman Library.
3. IMF, “Payment Systems, Monetary Policy, and the Role of the Central Bank”, 1998.
4. Mizen, Paul (ed.), “Central Banking, Monetary Theory and Practice: Essays in Honour of Charles Goodhart, Volume One”, Edward Elgar, 2003 – also available on the shelves of the Albert Sloman Library.
5. Siklos, Pierre, “The Changing Face of Central Banking: Evolutionary Trends since World War II (Studies in Macroeconomic History)”, Cambridge University Press, 2002 – also available on the shelves of the Albert Sloman Library.
6. Lavoie, Marc and Seccareccia, Mario (eds.), “Central Banks in the Modern World: Alternative Perspectives”, Edward Elgar, 2004 – also available on the shelves of the Albert Sloman Library.

Relevant journals and their websites

1. <http://www1.elsevier.com/homepage/sae/econworld/econbase/monec/frame.htm> – *Journal of Monetary Economics*, Elsevier Science: since its foundation in 1975, it has established itself as the top periodical reference for theoretical and empirical research in the broad field of monetary economics; *JME* is accessible for reading either at the Albert Sloman Library or via its EBSCO Host Electronic Journal Service facility (the issues of the most recent 12 months, in the latter case, with Essex password).
2. <http://webmail.econ.ohio-state.edu/john/GenInfo.php> – *Journal of Money, Credit and Banking*, Ohio State University Press: founded in 1969, *JMCB* is a leading professional journal in the areas of money and banking, credit markets, regulation of financial institutions, international payments, portfolio management, and monetary and fiscal policy; it is accessible for reading either at the Albert Sloman Library or in electronic format via JSTOR (up to 2002, in the latter case) or Business Source Premier (with Essex password).
3. http://www.elsevier.com/wps/find/journaldescription.cws_home/505558/description#description – *Journal of Banking and Finance*, Elsevier Science: a leading journal specialised in the analysis of financial institutions and the money and capital markets within which they function, *JBFB* is accessible

for reading either at the Albert Sloman Library or via its EBSCO Host Electronic Journal Service facility (the issues of the most recent 12 months, in the latter case, with Essex password).

4. http://www.elsevier.com/wps/find/journaldescription.cws_home/600113/description#description – *Journal of International Financial Markets, Institutions & Money*, Elsevier Science: founded in the early 1990s, *JIFMIM* has been focusing on articles which deal with the international aspects of financial markets, institutions and money; unfortunately, it is not (yet) available at the Albert Sloman Library.

5. <http://www1.elsevier.com/homepage/sae/econworld/econbase/jimf/frame.htm> – *Journal of International Money and Finance*, Elsevier Science: since its launch in 1982, *JIMF* has built up a solid reputation as a high-quality scholarly journal devoted to theoretical and empirical research in the fields of international monetary economics, international finance, and the rapidly developing overlap area between the two; it is accessible for reading either at the Albert Sloman Library or via its EBSCO Host Electronic Journal Service facility (the issues of the most recent 12 months, in the latter case, with Essex password).

6. <http://www.centralbanking.co.uk/publications/journals/cbj.htm> – *Central Banking*, Central Banking Publications Ltd: launched in 1990 and published quarterly, *CB* is the first journal dedicated exclusively to reporting, analysing and commenting on the activities of the central banks; unfortunately, it is not (yet) available at the Albert Sloman Library.

7. <http://www.ijcb.org/> – *International Journal of Central Banking*, an initiative of the central banking community, *IJCB* is a new quarterly publication (launched in 2005) that features articles on central bank theory and practice, with special emphasis on research relating to monetary and financial stability; unfortunately, it is not (yet) available at the Albert Sloman Library.

8. http://www.elsevier.com/wps/find/journaldescription.cws_home/505576/description#description – *Journal of Financial Economics*, Elsevier Science: another leading, since 1974, journal within the broader field of finance which now seeks to publish papers that raise a new question or pose an old one in an innovative way as well as papers that test theories in specialised ways or document interesting phenomena; *JFE* is accessible for reading either at the Albert Sloman Library or via its EBSCO Host Electronic Journal Service facility (the issues of the most recent 12 months, in the latter case, with Essex password).

Other useful websites

1. <http://www.imf.org/> – International Monetary Fund (IMF), Washington, D.C.
2. <http://www.bis.org/index.htm> – Bank for International Settlements (BIS), Basle
3. <http://www.ecb.int/> – European Central Bank (ECB), Frankfurt
4. <http://federalreserve.gov/> – Board of Governors of the Federal Reserve System (the Fed) Washington, D.C.
5. <http://www.boj.or.jp/en/> – Bank of Japan (BoJ), Tokyo
6. <http://www.bankofengland.co.uk/Links/setframe.html> – Bank of England (BoE), London
7. <http://www.snb.ch/d/index3.html> – Swiss National bank (SNB), Zurich and Bern
8. <http://www.essex.ac.uk/afm/mmfm/> – *Money Macro and Finance* (MMF) Research Group
9. <http://www.ecbs.org/> – European Committee for Banking Standards (ECBS)
10. http://economics.uchicago.edu/news_workshops_banking.shtml – University of Chicago Department of Economics *Money & Banking Workshop*
11. <http://www.wfhummel.cnhost.com/> – William Hummel's website on *Money: What It Is, How It Works*
12. <http://www.ex.ac.uk/~RDavies/arian/origins.html> – Roy Davies' website-essay on *Origins of Money and of Banking* based on the book by his father Glyn Davies, "A History of Money: From Ancient Times to the Present Day", 2002 (3rd ed.), University of Wales Press

Course Outline

All starred (*) references below are recommended as *essential* readings whereas the non-starred ones are suggested either as *supplementary* readings for a deeper understanding of a particular whole topic or as *background* readings on certain aspects of it.

1. Money, Banking and the Financial System: An Introduction

1.1 Payments: Barter, Money and Credit

- (1) *Mishkin, Chapters 1 and 3

1.2 Macroeconomics: Money, Output, Inflation and Interest Rates

- (1) *Mishkin, Chapters 1 and 3

1.3 The Financial System and Its Key Institutions: Instruments, Markets and Intermediaries

- (1) *Mishkin, Chapter 2
- (2) Howells and Bain, Sections 1.1 and 1.2

1.4 The Financial System and Its Key Actors: Lenders and Borrowers

- (1) *Howells and Bain, Section 1.3

2. Financial Markets: Determinants and Role of Interest Rates

2.1 Interest Rates: Definition(s) and Behaviour

- (1) *Mishkin, Chapters 4 and 5
- (2) Howells and Bain, Section 7.1

2.2 Interest Rates and Their Risk and Term Structure

- (1) *Mishkin, Chapter 6
- (2) Howells and Bain, Section 7.7

2.3 Interest Rates and the Stock Market

- (1) *Mishkin, Chapter 7

2.4 Interest Rates, Prices and the Exchange Rate: PPP and UIP

- (1) *Mishkin, Chapter 19
- (2) Howells and Bain, Sections 8.3 and 8.4

3. Financial Intermediation: Rationale, Competition, Regulation

3.1 Analysing Financial Structure

- (1) *Mishkin, Chapter 8

3.2 Economic Rationale for Financial Intermediation

- (1) *Mishkin, Chapter 8

3.3 Banking Industry: Competition

- (1) *Mishkin, Chapter 10

3.4 Banking Industry: Regulation

- (1) *Mishkin, Chapter 11
- (2) Fraser, Gup and Kolari, Chapter 2 (on US)
- (3) Howells and Bain, Chapter 12 (on UK)

4. Central Banking and the Supply of Money

4.1 Free Banking or a Central Bank?

- (1) *Goodhart, Chapters 1, 2 and Appendix
- (2) Thornton, H., "An Enquiry into the Nature and Effects of the Paper Credit of Great Britain", Rinehart and Co., 1939 (reprint, first published in 1802)
- (3) Bagehot, W., "Lombard Street", Homewood Ill.: Richard D. Irwin, 1962 (reprint, first published in 1873)

4.2 Central Banks: Functions and Independence

- (1) *Goodhart, Chapters 7 and 8
- (2) Mishkin, Chapter 14 (on the Federal Reserve System)
- (3) Howells and Bain, Chapter 12 (on the Bank of England)

4.3 The Money Supply Process

- (1) *Mishkin, Chapter 15

4.4 Determinants of the Money Supply

- (1) *Mishkin, Chapter 16

5. The Demand for Money and Monetary Theory

5.1 Money Demand: Theories and Empirics

- (1) *Mishkin, Chapter 22

5.2 Money and Policy in IS-LM and AD-AS Analysis

- (1) *Mishkin, relevant sections of Chapters 23, 24 and 25

5.3 Money and Inflation

- (1) *Mishkin, Chapter 27

5.4 Rational Expectations and Implications for Policy

- (1) *Mishkin, Chapter 28

6. Formulation and Implementation of Monetary Policy

6.1 The Market for Reserves and the Federal Funds Rate

(1) *Mishkin, Chapter 17

6.2 Tools of Monetary Policy

(1) *Mishkin, Chapter 17

6.3 Goals and Targets of Monetary Policy

(1) *Mishkin, Chapter 18

6.4 Nominal Anchors and Monetary Strategies

(1) *Mishkin, Chapter 21

6.5 The Transmission Mechanism: Money and Credit Channels

(1) *Mishkin, Chapter 26

7. Commercial Banking: From Deposit/Lending to Risk Management

7.1 Commercial Banking as a Business

(1) *Fraser, Gup and Kolari, Chapter 1

7.2 Bank Performance, Deregulation and Risk Management

(1) *Fraser, Gup and Kolari, Chapter 3

7.3 Asset/Liability Management: Dollar and Duration Gaps

(1) *Fraser, Gup and Kolari, Chapter 5

7.4 Liquidity Management

(1) *Fraser, Gup and Kolari, Chapter 9

8. Financial Innovations: Off-Balance Sheet Activities of Banks

8.1 Financial Innovation: Rationale and Types

(1) *Mishkin, Chapter 10, pp 232-243

8.2 Why Banks Developed Off-Balance Sheet Activities

(1) *Fraser, Gup and Kolari, Chapters 6 and 14

8.3 Financial Guarantees and Contingent Claims

(1) *Fraser, Gup and Kolari, Chapter 14

8.4 Financial Derivatives, Hedging and Securitisation

- (1) *Fraser, Gup and Kolari, Chapters 6 and 14
- (2) *Mishkin, Chapter 13

8.5 Other Off-Balance Sheet Activities of Banks

- (1) *Fraser, Gup and Kolari, Chapter 14

9. Financial Innovations: Nonbank Finance and Electronic Money

9.1 Disintermediation

- (1) *Fraser, Gup and Kolari, Chapter 15
- (2) *Mishkin, Chapter 12

9.2 Nonbank Finance: Types and Innovations

- (1) *Fraser, Gup and Kolari, Chapter 15
- (2) *Mishkin, Chapter 12

9.3 Electronic Funds Transfer: Types and Innovations

- (1) *Fraser, Gup and Kolari, Chapter 13

9.4 Seignorage

- (1) *Fraser, Gup and Kolari, Chapter 13

10. Money, the State and the Trend toward Cashlessness

10.1 Money and the State

- (1) Glasner, D., "Free Banking and Monetary Reform", Cambridge University Press, 1989
- (2) Podolski, T., "Financial Innovation and the Money Supply", Basil Blackwell, 1986

10.2 The Trend toward Cashlessness

- (1) *Markose, S. and Y.J. Loke, "Changing Trends in Payment Systems For Selected G10 and EU Countries 1990-1998", *International Correspondent Banking Review Yearbook 2000/2001*, April 2000
- (2) Markose, S. and Y.J. Loke, "The Microstructure of the Trend To Cashlessness: UK and USA Compared", University of Essex, Economics Department, 2000, mimeo

10.3 The Demise (?) of Monetarism: Deregulation, Securitisation, Disintermediation, ...

- (1) *Goodhart, C. "Financial Innovation and Monetary Control", *Oxford Review of Economic Policy*, 1986, Vol. 2 (4), pp. 79-101

10.4 Gold Standard, Paper Standard, Electronic Standard – an Assessment

- (1) Podolski, T., "Financial Innovation and the Money Supply", Basil Blackwell, 1986