

ECON 308

MONEY AND BANKING

PROF. ALEXANDER MONGE-NARANJO
Department of Economics
Northwestern University
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1 Contact Information

Alexander Monge

All the relevant materials and announcements will be posted in my website,
<http://www.faculty.econ.northwestern.edu/faculty/monge/>

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Adeline Delavande

Adeline will be the T.A. for this class. She will conduct review sections on Fridays on the problem sets.

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2 General Description

This course will cover basic concepts, tools and facts needed to understand the functioning of financial markets. We start by studying the basic concepts and formulas for the valuation of securities, as well as the determination of the various interest rates, including the role of Central Banks and monetary policy. We will briefly review some of the institutional details of the U.S. economy. In the second part of the class, we will study the most fundamental aspects

of portfolio theory, and topics on the economics of financial intermediation, such as incentive problems in bank-borrower relationships, models of bank panics and implications for banking regulations. If time permits, we will finish the class by studying the most essential aspects of foreign exchange markets and reviewing the debate on the recent crises in Asia and Argentina.

3 Texts

The **textbook** for the class is by Frederic Mishkin and Stanley Eakins *Financial Markets and Institutions*, Addison Wesley Longman, Third Edition. In the second part of the course, after the midterm examination, we will also make use of a **course packet** which will be available for sale in the main office of the Department of Economics.

4 Problem Sets

Problem sets will be a very important part of the class. Exams will be based on them. In total we will have eight problem sets, but only four of them will be graded.

Previous problem sets and their solutions will be available in my web-page.

5 Evaluation

The final grade will be based on problem sets, a midterm examination and a final examination. The weights are as follows:

Problem Sets	25%
Midterm Examination	25%
Final Examination	50%

The Midterm examination will be defined in the next lecture.

Students who wish the re-grading of the midterm or the final must submit a request in written form, clearly explaining the case.

6 Program of Lectures

The following is the plan for the lectures:

- Jan 7** Introduction and Description of the Course. ME, Ch. 1,2.
- Jan 9** Financial Markets, securities, financial intermediaries. Interest rates, present value calculations. Suggested reading: ME, Ch. 3
- Jan 14** Measuring Interest. Yields and returns. Suggested reading: ME, Ch. 3.
- Jan 16** Interest rate risks, duration and hedging. Suggested reading: ME, Ch. 3 and Ch. 22 (pp. 624-640)
- Jan 21** Cont. Interest rate risks, duration and hedging. Suggested reading: Ch. 22 (pp. 624-640)
- Jan 23** Risk and term structure of interest rates. Suggested reading: ME, Ch. 5.
- Jan 28** Theories of the term structure of interest rates. Determination of the interest rates. Suggested reading: ME, Ch. 5.
- Jan 30** Determination of interest rates. Theory of efficient capital markets. Suggested reading: ME, Ch. 4 and 6.
- Feb 4** Theory of efficient capital markets. Suggested reading: ME, Ch. 6. The Federal Reserve System and conduct of monetary policy. Suggested reading: ME, Ch. 5, 7 and 8.
- Feb 6** Conduct of monetary policy (cont), Money and Capital Markets . Suggested reading: ME, Ch. 8,9 and 10.
- Feb 11 Midterm Examination**
- Feb 13** Decision under uncertainty. Suggested reading: BKM Ch. 5 (course packet)
- Feb 18** Portfolio theory I. Suggested reading: BKM Ch. 6 (course packet)
- Feb 20** Portfolio theory II. Suggested reading: BKM Ch. 7 (course packet)
- Feb 25** The CAPM. Suggested reading: Jagannathan/McGrattan (course packet)
- Feb 27** The CAPM (cont). Financial intermediation: Bank-borrower relationships, moral hazard, adverse selection and other incentive problems. Suggested reading: Jagannathan/McGrattan (course packet). ME Ch. 14 and 15; Doepke, Lehner and Sellgren, Ch. 17. (course packet)
- March 4** Financial intermediation: (cont) Suggested reading: ME Ch. 14 and 15; Doepke, Lehner and Sellgren, Ch. 17. (course packet)

March 6 Bank panics. Banking regulation. Lender of last resort, deposit insurance and partial suspensions. Suggested reading: ME, Ch. 18. Diamond and Dybvig (course packet)

March 11- March 13 Reading period. No lectures.

March 18-March 22 Final exam according to University Calendar.

7 Program for Problem Sets

Problem sets are due at the beginning of the T.A. sessions.

Jan. 18th Problem Set # 1. Not graded.

Jan. 25th Problem Set # 2. Graded.

Feb. 1st Problem Set # 3. Not graded.

Feb. 8th Problem Set # 4. Graded.

Feb. 15th Problem Set # 5. Not graded.

Feb. 22nd Problem Set # 6. Graded.

March 1st Problem Set # 7. Not graded.

March 8th Problem Set # 8. Graded.