

California State University, Sacramento  
Department of Economics

**Syllabus**  
**Economics 135-02: Money and Banking**  
**Spring 2017**

Lecture TTH 10:30-11:45 a.m. in Amador 217 (CRN #35587)  
Course Web Page: <http://www.csus.edu/sacct>

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**Office Hours:** Monday 1:00-2:30 p.m.  
Thursday 1:00-2:30 p.m.  
and by appointment

**Please read this entire syllabus completely and thoroughly!!!**

I have devoted a significant amount of time and effort to developing it and you should consider it to be the ground rules. It is essentially a contract between you and me. "I didn't read the syllabus" is not an acceptable excuse for failing to abide by the rules and will not exempt you from the consequences.

**Catalog Description**

**ECON 135:** Examines the role of financial markets, the banking system, and the Federal Reserve System in the economy. Included are an introduction to present value and the behavior of interest rates, analysis of money creation, and evaluation of monetary policy. Prerequisite: ECON 1A and MATH 24 or MATH 26A or MATH 30 with a minimum "C" grade

**A Note on Prerequisites**

I will expect that you remember and are able to apply basic concepts introduced in Econ 1A including the basics of supply and demand, definitions of macroeconomic aggregates including GDP, the price level and inflation, and measures of the money supply, the basics of fiscal and monetary policy and the basic AS-AD model. From your math class, I will expect you to have the ability to do simple arithmetic and algebra and to solve systems of equations, to have an understanding of the principles and use of natural logarithms, to have an understanding of growth rates, and to have the ability to calculate and interpret simple derivatives. If you are weak on any of these basic concepts, you should review them. While I will very quickly review some of these basic concepts as we come across them, I will not take the time during the semester to provide extensive instruction on prerequisite material.

**Academic Rigor and Workload**

This is a demanding upper division university level class for you which you will receive three credit hours (units of credit) upon successful completion.

The current edition of the University Catalog which is available online states the following:

As of July 1, 2011 federal law (Title 34, Code of Federal Regulations, sections 600.2 and 600.4) requires all accredited institutions to comply with the federal definition of the credit hour. For all CSU degree programs and courses bearing academic credit, the "credit hour" is defined as "the amount of work represented in intended learning outcomes and verified by evidence of student achievement that is institutionally established equivalency that reasonably approximates not less than one hour of classroom or direct faculty instruction and *a minimum of two hours of out-of-class student work each week for approximately fifteen weeks* for one semester.

This means two things. First, you must attend class and you must also devote a minimum of six hours per week outside of class to reading and study for a minimum total of nine hours per week. Note that weaker students will have to devote more time to do well. Second, you must also pass course exams, demonstrating that you have actually learned something and have attained the course objectives stated below. Do not expect to receive a satisfactory grade unless you are willing to make the time commitment necessary to do the required work. You will be graded on your productivity, competency, and proficiency, not your effort, nor your intentions, nor any factor other than your performance on exams.

### **Electronic Devices**

In an effort to reduce the multitasking which research shows at best reduces your productivity and at worst reduces your IQ, this course has a no-electronic-devices-during-lecture policy. Laptops should be closed. Phones, tablets, pads, pods, Apple or Google watches and other devices should be turned off and stowed in your pack or under your chair. **Students caught violating this policy will be assumed not to be fully engaged in the lecture and may be penalized with a 0.10 grade point reduction in their final grade for each offense.**

### **Scope and Objectives**

Economics 135 is designed to examine the structure and economic function of the banking and financial system in detail. Included in this is a discussion of the determination of interest rates including the term and risk structure of rates, the role of the Federal Reserve System and its interaction with the commercial banking system and other financial and nonfinancial institutions and firms in the economy, an analysis of the determination of the money supply and theoretical and empirical analysis of the demand for money. We also will address in detail the function of the commercial banking system and to a lesser degree the functioning of the shadow banking system, the means by which the Fed conducts monetary policy and the effect of those policy actions on the real economy. The primary objective of this course is for you to gain a reasonably thorough understanding of the economics of money, banking and financial markets, the functioning of the Fed and the interaction of monetary policy, financial markets and the real economy.

By the end of this course, you are at a minimum expected to be able to demonstrate

- an understanding of the importance and function of the financial sector in directing the use of scarce capital and spreading risk;
- an understanding of the main financial instruments;
- an understanding of the nature of money and definitions of the money supply;
- an understanding of the money creation process;
- an ability to apply and interpret the concepts of present value, yield and internal rate of return;
- the ability to explain the determination of interest rates using both the loanable funds and liquidity preference frameworks;
- the ability to explain the demand for financial assets using portfolio choice theory;
- an understanding of the determinants of the term structure and risk structure of interest rates;
- an understanding of the institutional structure, operation and microeconomics of banks as part of the financial system;
- the ability to explain monetary theory and its relevance to macroeconomic policy against the background of the main financial institutions and markets;
- an understanding of monetary policy goals and targets;
- an understanding of the implementation and transmission of traditional and non-traditional monetary policy tools;
- the ability to use economic models to analyze the effects of monetary policy measures;
- the ability to discuss current issues in relation to the formulation and operation of monetary policy;
- a knowledge of the theoretical structure of an open economy with particular emphasis on monetary policy formulation and implementation;
- the ability to analyze and predict key economic variables when the economy is faced with internal and external market shocks.

## **Textbooks and Other Reading Material**

The required textbook for the course is *The Economics of Money, Banking and Financial Markets* 11<sup>th</sup> edition by Frederic S. Mishkin (Pearson, ISBN 978-0-13-383679-0) which is available in the campus bookstore and from numerous online vendors. You can also probably get by with the 10<sup>th</sup> edition as well, though page numbers will vary. We will not be using any of the electronic resources that are packaged with the new book, so it is perfectly acceptable to buy a used book that doesn't have any of these.

The book will primarily be used to provide background and core material that will supplement and complement the lectures. There will be additional (required) articles and book chapters that will be available from the class web site. I also may send you email links to other short readings over the course of the semester. All assigned readings may be included on the exams. Note that my lectures will not simply be a rehash of the textbook and other assigned readings, but rather will weave together material from all the various sources I assign and will also at times include a good deal of additional information. In order to do well you will need to attend lectures on a regular basis, take careful notes and stay current with the reading assignments as there will be no single source you can consult the night before an exam in a last ditch effort to squeak by with a minimal passing grade.

## **E-mail Communication and Etiquette**

The best way to contact me outside of class and office hours is via email. I will do my best to respond to emails within 24 hours during normal business hours. Keep in mind though that in an effort to reduce my own multi-tasking and its' associated costs, I do not sit in front of a computer with internet access all day every day. I will send necessary class announcements by email using the SacSend messaging system or SacCT, so be sure your email on file with the University is correct, one you check regularly during the week, and that your inbox isn't full.

You should view your e-mail as a professional business communication in which you are trying to impress me with your intelligence and ability to do well in my class, not as a text message to one of your friends or classmates. In the interest of achieving this goal, emails must have "Econ 135" in the subject line. Additionally, please address me in a more respectful manner than "Hey," use proper grammar, capitalization and punctuation in your message and sign your emails with both your first and last names. Emails that don't meet these minimum expectations will likely be discarded without being read. For further guidance on writing proper and effective emails to your professors, you should read the article at <https://www.insidehighered.com/views/2015/04/16/advice-students-so-they-dont-sound-silly-emails-essay>.

## **Course Requirements and Grading:**

### **Attendance**

You are expected to regularly attend lectures and are strongly encouraged to actively participate. While there is no explicit penalty for missing class, it is nonetheless the case that students who regularly skip class almost always do poorly. In the event you do miss class, you need to get notes from a classmate. Do not expect me to repeat the missed material for you either during office hours or through email. I also do not provide lecture notes to those who miss class. **You should exchange email addresses with classmates so you have someone to contact for notes and information in the event you do miss a class.**

### **Problem sets**

Several problem sets will be assigned over the course of the semester. Problem sets will be posted to SacCT and will generally be due one week after they are assigned. For any given problem set, only a portion of the questions will be graded. In total, problem sets will account for 15% of your course grade with the lowest score being dropped. Problem sets will be due at the beginning of class on the due date and must be turned in on time as no late work will be accepted. If you are unable to attend class to turn in your problem set, you may have a friend or classmate turn it in for you. There will be no make-ups for missed problem sets, though if you miss only one it will not count against you as that will be the low score that is dropped.

## Exams

There will be two midterm exams (each accounting for 25% of your course grades) and a comprehensive final examination (accounting for 35% of your course grade). Each closed book exam will have a small number of multiple choice questions as well as short answer, problem solving and essay questions and will take place on the dates indicated below on the course calendar. The final exam will be comprehensive, but weighted more heavily (approximately 50%) toward new material covered after the second midterm. For each exam you will need a Scantron form 882 or 882-E. You also may use a basic non-programmable, non-graphing four function calculator (one with no financial or statistics functions) as well as a single 3" x 5" note card (both sides).

**There will be no make-up midterm exams.** In the event you miss a midterm exam due to a verifiable medical or family emergency or required military service I will reweight your remaining midterm and the final exam so that each accounts for an additional 12.5% of your course grade. If you miss a midterm exam for any reason you must contact me by phone or email by 8:00 a.m. on the day after examination. If you fail to contact me you will receive a score of zero on that exam. If you will miss a midterm due to a campus sponsored activity you need to contact me regarding the conflict during the first week of class. These issues will be handled on a case by case basis. If however you fail to contact me during the first week of class, no accommodations will be made. Regardless of your grade going into the final, if you do not complete the final exam, you will receive an "F" in this course. **The final exam is mandatory.**

Exam answers will be graded not only on the correctness and completeness of your answer, but also on the clarity and quality of your writing and work. Minor spelling and grammatical errors will be overlooked; however, answers that are illegible, rambling, off topic, or poorly organized will not receive high marks. I also don't give substantial amounts of credit for answers demonstrating only that you may "sort of have the idea." Either you know the material or you don't. Your exam grade reflects the degree to which you have convinced me that you know the material and have attained the course objectives.

## Grading

I do not distribute grades according to an arbitrary curve. While there *may* be a curve, the actual distribution is determined by the overall quality of student performance. I will give **approximate** distributions after each midterm exam in order to give you an idea of where you stand in the class. I will not however be able to give you an exact grade at any time during the class. I also will not be able to answer the perennial question "what do I need to get on the final to pass the class?" as the answer to this question will depend on how all of your classmates do on their own final examinations. I will simply tell you to do the very best you can. While it is theoretically possible for everyone to earn an A, it is equally possible for everyone to earn a C. Past performance in upper division classes indicates that the overall class average will likely be a B-/C+ with 15% -20% or so of students earning an A or an A-. Past results are however no guarantee of future results.

## Course Calendar

The components of your course grade, weighting and due dates are listed below. Note that the dates given are firm and will not be changed. If you have unavoidable conflicts with these dates you should not take the class.

Date	Activity or Assignment	Percent of Total Grade
Throughout	Problem Sets	15%
2/28/17	First Midterm Exam	25%
4/11/17	Second Midterm Exam	25%
5/18/17	Final Exam (10:15 a.m. – 12:15 p.m.)	35%

## Policies

### **Academic Honesty:**

Academic honesty is expected. In fairness to the many students who work hard and put in an honest effort, those who in any way engage in acts of academic dishonesty, or cheating, will be treated most harshly. To do otherwise or to in any way tolerate academic dishonesty would devalue all honest student's education. I encourage students to discuss economics and the class material together (outside of class) and to help each other in solving problems and in coming to understand the material. In fact, you will find this class much easier if you do form study groups. Nevertheless, work submitted for a grade must ultimately be the work of the individual student – not copied from another student or from any other source. It is my policy to at a minimum assign a grade of zero for any homework or problem set on which cheating occurs. In the event of any act of cheating on an examination or paper submitted for a grade, my policy is to assign a grade of F in the course. I will also pursue all appropriate disciplinary measures provided by University policy.

### **Drop Policy and WU Grades**

I strictly enforce Department and University drop policies posted at <http://www.csus.edu/econ/For%20Students/policies.html#1>. I will only assign WU grades to students who take no exams. Students who disappear after taking any exam will receive a grade of F.

### **Handouts and Return of Student Work**

In the event that there are handouts, I will only hand them out once. If you miss class, you will need to get this material from a classmate as I do not keep extra copies in my office after class is over. I also bring exams or other student work for return only once. After that, you must come to my office during office hours to retrieve it.

### **Talking in Class**

Please don't talk to each other during class. If you have questions, ask me, not the student sitting next to you. Talking in class is rude and distracting, both to me and to other students.

### **Punctuality**

Please do your best to arrive for class on time. If you must arrive late, please do so as inconspicuously as possible. Plan on staying for the entire class session as leaving early is rude and disruptive. If in some special circumstance you do need to depart early, let me know before class starts, though if you make a habit of leaving early, I will ask that you not return.

### **Recording of Lectures**

Audio and/or any kind of video recording of lectures is prohibited and is a violation of federal copyright laws unless you have a learning disability that requires such recording (see below).

### **Selling or Posting of Notes**

It is a violation of state law for you to either sell or publicly post lecture notes from my class. You are encouraged to freely (that means without monetary compensation) share notes amongst yourselves. You may not in any way profit financially from notes taken in my class though.

### **Accommodations for Students with Disabilities**

If you have a disability and require accommodations, you need to provide disability documentation to Services for Students with Disabilities, Lassen Hall 1008, (916) 278-6955. They will determine your needs and provide you with the necessary forms to bring to me. Please discuss your accommodation needs with me after class or during my office hours early in the semester. You must plan ahead for any necessary accommodations; do not expect me to provide accommodations if you wait until the last minute to tell me what you need. If your accommodation requires any kind of recording of lectures, you must not share, post, or in any other way make the recordings publicly available and must erase them once the semester is over.

## Tentative Course Outline

Below is a tentative course outline. Readings from the class text are indicated as Mishkin. We almost certainly will not be able to cover everything on this outline and I will delete some material as necessary. (To some degree, what we delete may be determined by student interest.) I may also add a small number of readings to some topics. Any changes will be announced by email and if the changes are substantial, an updated outline will be posted to SacCT. Two topics, denoted with an asterisk (\*) are included for which I will not discuss the material in lecture, but you are nevertheless responsible for reading the material and learning it. Both these topics are a rehash of material that is well covered in econ 1A.

### **Part I: Basics of the Monetary System and Financial Markets**

- A. Overview of the Financial System  
Mishkin, chapters 1-2
- B. Money: Definition and Measurement\*  
Mishkin, chapter 3 (Assigned as reading only – no lecture)
- B. DPV and Yields  
Mishkin, chapter 4  
chapter 4 Web Appendix “Measuring Interest Rate Risk: Duration (on SacCT)
- C. Behavior of Interest Rates: Loanable Funds and Liquidity Preference plus Extensions  
Mishkin, chapter 5  
chapter 19, pp. 465-468  
Web Appendix 5-1 “Models of Asset Pricing” (on SacCT)  
Web Appendix 5-3 “Loanable Funds Framework” (on SacCT)  
Web Appendix 19-1 “The Baumol-Tobin and Tobin Means Variance Model” (on SacCT)  
David Laidler, *The Demand for Money*, excerpt (on SacCT)  
“Basic Concepts of Risk Preferences” (on SacCT)
- D. Risk and Term Structure of Interest Rates  
Mishkin, chapter 6
- E. The Stock Market, Rational Expectations and the Efficient Market Hypothesis  
Mishkin, chapter 7

### **Part II: The Federal Reserve and Monetary Policy**

- A. Central Banks and the Federal Reserve System\*  
Mishkin, chapter 13 (Assigned as reading only – no lecture)
- B. The Money Supply Process  
Mishkin, chapter 14  
Web Appendix 14-1 “The Fed’s Balance Sheet and the Monetary Base” (on SacCT)  
Web Appendix 14-2 “The M2 Money Multiplier” (on SacCT)
- C. Monetary Policy Tools  
Mishkin, chapter 15
- D. Monetary Policy Strategy and tactics  
Mishkin, chapter 16  
Web-Appendix 16-2 “A Brief History of Federal Reserve Policymaking” (on SacCT)
- E. Monetary Policy Transmission  
Mishkin, chapter 25

### **Part III: Financial Institutions: Operation, Regulation and Crises**

- A. An economic Analysis of Financial Markets: Asymmetric Information  
Mishkin, chapter 8  
Akerlof, “The Market for Lemons: Quality Uncertainty and the Market Mechanism” (on SacCT)
- B. Financial Institution Management  
Mishkin, chapter 9  
chapter 9 Web Appendix 1 “Duration Gap Analysis” (on SacCT)  
Freixas and Rochet, excerpt from *Microeconomics of Banking* (on SacCT)
- C. Economic Analysis of Financial Regulation  
Mishkin, chapter 10  
Additional Readings on Recent Mergers TBA
- D. Banking Industry: Structure, Competition and Shadow Banking  
Mishkin, chapter 11  
Additional Reading TBA
- E. Financial Crises  
Mishkin, chapter 11  
Brunnermeier, “Deciphering the Liquidity and Credit Crunch 2007-2008” (on SacCT)  
Cecchetti, “Crisis and Response: The Federal Reserve in the Early Stages of the Financial Crisis” (on SacCT)  
“”Conclusions of the Financial Crisis Inquiry Commission” (on SacCT)

### **Part IV: Monetary Policy and the Macro Economy**

- A. The IS Curve  
Mishkin, chapter 20
- B. The Monetary Policy and Aggregate Demand Curves  
Mishkin, chapter 21
- C. Aggregate Demand and Aggregate Supply  
Mishkin, chapter 22