Economics 335 – Money and Banking

Instructor: Xinyu Hou  (hou.xinyu@wustl.edu)

We will meet every weekday from 11:00AM to 12:45PM, Jun. 11 - Jul. 13.

My office is in Seigle Hall 354, and my office hours are right after class. Please e-mail me if you want to meet outside of my regular office hours.

Scope of the course

This is an introductory course to money and banking theory, for those who want to understand economic analysis in monetary and financial systems. We will work on developing economic intuition for organizing concepts and facts, through acquiring basic analytical tools for evaluating the impact of events and financial issues. We will start by focusing on the historical context of money, with minimum but necessary mathematical tools, in order to think critically and logically about how things evolved to the complicated modern system we have now. It would be beneficial if you know basic economic principles and some level of accounting (balance sheet and double-entry bookkeeping); but it would not be a problem if you don’t, in that case we will go over some useful concepts.

We are also going to use one or two classes to master some technical aspects like present value, discounting, and interest rates. To understand the banking system, we would trace back to the beginning when early banks first appeared, in the west, in India, as well as in ancient China; then the modern banks in the European Late Middle ages. It would also be good practice to form study groups in order to delve deeper into the early banks in countries we are interested in, or special types of banks. Next, we will proceed with answering the question of how central banks appeared and through what mechanism they implement monetary policies. Hopefully, we could get a bit of a grasp of what the implication of monetary policy would be given different states of the economy.

The scope would be adjusted according to your current knowledge and understanding of economics. You are always welcome to express your questions and doubts, or to bring up suggestions or additional issues.

Textbooks and materials:
1) Glenn, R. Hubbard, Money, Banking and the Financial System, Pearson, 3rd Edition
2) Lecture Notes from instructor

Grading:
Your grade will be determined by two non-cumulative in-class exams, group presentations, and everyday homework assignments (only one question for a day, 20 in total). The maximum number of points in the course is 100. Exams 1 and 2 are worth 25 points each. Group presentations are worth 20 points. The homework assignments are worth 1.5 points each. The first assignment will be handed out on the first day of class and due on the third day, so that you have two days to think and write down the answers.

Hand in your homework assignments to the instructor every day before class starts. You could discuss with your classmates about the homework, but please write in your own words.

Exams:
1) Midterm, Wednesday June 27th, in class. (Review session on June 26th)
2) Final exam, Friday July 13th, in class. (Review session on July 12th)

Academic integrity:
You are held to the standards of academic integrity established by Washington University and your individual college. In particular, evidence of cheating on an exam will result, initially, in a failing grade on the exam, and immediate academic disciplinary action. If you ever feel that these standards of academic integrity are not being met, please notify me or an undergraduate advisor immediately. If you are uncertain about the policy on academic integrity at Washington University, refer to your undergraduate advisor, to the university’s Student Judicial Procedures, or to your school’s statement of student academic integrity. For the College of Arts & Sciences’ students, the latter is published each semester in the Course Listings booklet.

Course Outline and Reading Suggestions

Week 1 (6/11-6/15):
- A first look at the “theory of money”
  The many things called “Money” in history and today – why we care. Why they are so different from other traded commodities?
  The mystery of fiat money, and measuring money supply
  • Hubbard Chapters 1,2;
  • Lecture Notes 1;
  • https://en.wikipedia.org/wiki/History_of_money

- Breaking down the many concepts
  Interest rates, discounting, rate of returns, net present value…bonds, securities, assets,
liabilities and other basic financial and monetary concepts.

- Hubbard Chapters 1, 2 and 3;
- Lecture Notes 2

**Week 2 (6/18 - 6/22):**
- Inflation according to the Quantity Theory of Money. Money, Debt and the Government Budget Constraint. The Federal Reserve and money supply process
  - Hubbard, Chapter 13,14;
  - Lecture Notes 3;
  - https://en.wikipedia.org/wiki/Money_supply
  - http://www.frbsf.org/education/teacher-resources/datapost/macroeconomics/money-supply/

- Elementary financial derivatives: stock option, put and call. What makes stock different from bonds.
  - Hubbard, Chapter 6,7;
  - Lecture Notes 4;

**Week 3 (6/25 - 6/29):**
- The many things called “bank” in history and today. The role of banks and of fractional banking in the creation of money and credit.
  - Lecture Notes 5
  - https://en.wikipedia.org/wiki/History_of_banking_in_the_United_States

**Exam 1** Wednesday June 27th, in class. (Review session on June 26th)

**Week 4 (7/2 – 7/6):**
- Transaction costs, asymmetric information and moral hazard – what could go wrong inside the financial institutions
  - Hubbard, Chapters 4, 5, 6, 9 and 10;
  - Lecture Notes 6.

- Basic Economics of Banking. Commercial Banks, Investment Banks, Shadow Banking and Nonbank Financial Institutions.
  - Hubbard Chapters 10 and 11;
  - Lecture Notes 7;
  - https://www.newyorkfed.org/research/staff_reports/sr559.html
Week 5 (7/9 – 7/13): Breaking down financial crisis
- Bank runs and the original role of central banks. How financial crisis occur, most of the times
  • Hubbard, Chapters 12;
  • Lecture Notes 8, 9.

Exam 2 Friday July 13<sup>th</sup>, in class. (Review session on July 12<sup>th</sup>)