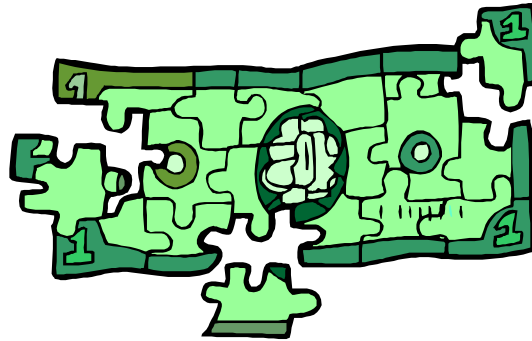


Our Financial System in Perspective



July Experience 2000
Davidson College

About This Course

This course is designed to provide a rigorous understanding of several important aspects of the structure of our financial and monetary system. Among other things, it stresses knowledge of the pattern of linkages between the numerous interest rates we observe around us. A discussion of the structure and workings of the Bond and Money Markets constitutes the background for analyzing how these interest rates are determined. This course also provides economic reasons for the great importance of Banks within the overall framework of the financial system, and reviews their basic operational practices. Finally, a description of the structure of the Federal Reserve, its policy tools, and its policy conduct in influencing our economic prosperity, connects these topics together. A strong effort is made throughout to relate the course materials to the world around us.

Requirements

- Three assignments: which will consist of problem sets, short answers, or essays. Equally weighted, these assignments together will constitute 15% of the course grade.
- Three tests: whose schedule and weights are provided below:

1 st Test	Friday, July 14	25% of the course grade
2 nd Test	Friday, July 21	30% of the course grade
3 rd Test	Thursday, July 27	30% of the course grade

- Journal: due in class on Friday, July 28. Your Journal should be based on one economic news story that you are required to read each day. The Journal should cover news reports for the ten business days starting Wednesday July 12, and ending Tuesday July 25. It should be typed with double spacing, with no more than two news summaries per page. The Journal is mandatory. Non-submission of it will result in grade reduction by a full grade point.

Resources

Text: Frederic S. Mishkin, *The Economics of Money, Banking, and Financial Markets*, 5th Edition, Addison Wesley Longman: New York, 1998. ISBN 0-321-01440-5.

Wall Street Journal (WSJ): You are encouraged to read the daily editions of the *Wall Street Journal*. These readings can provide you with material for your own Journal. I will let you know which sections of the *WSJ* would be most useful for you.

Articles: for discussion and comment will be provided to you in class.

Online: A list of useful links on the World Wide Web is provided below. These sites are sources of useful information on a wide variety of economic and financial issues and should appeal to a variety of interests. Please explore them at your leisure; many of them will provide you with information, data and analyses for your Journal. Effort has been made to ensure that each of the sites is current.

US GOVERNMENT DATABASES AND POLICY LINKS

www.whitehouse.gov/fsbr

www.bea.doc.gov

www.census.gov

<http://stats.bls.gov>

www.stls.frb.org/fred

www.fedstats.gov

INTERNATIONAL ISSUES AND DATA

www.worldbank.org

www.imf.org

www.unsystem.org

www.nber.org/pwt56.html

www.oecd.org

ECONOMIC POLICY: NEWS AND ANALYSIS

www.economist.com

www.wsj.com

www.slate.com

www.policy.com

www.socrates.berkeley.edu:3333/Budget (National Budget Simulator)

<http://netec.wustl.edu>

www.yardeni.com/country.html

ADD YOUR OWN _____

Grading Policy

- To receive any credit, assigned work must be submitted by the prescribed deadline.
- Tests must be taken in class according to the schedule provided.
- Prior permission from me is required for exceptions to these policies. Unexcused absence from a test will result in zero credit.
- The grade scale will be limited to H⁺, H, H⁻, P⁺, P, P⁻, F⁺, F, F⁻.

Office Hours

Weekdays 11:00 - 12:20

COURSE OUTLINE

A. The Market Mechanism

P. A. Samuelson and W. D. Nordhaus, *Economics*, 16th edition, Chapter 3. On Reserve.

- Demand:** Demand Schedule, Curve, and Function
Determinants of, and Changes in, Demand
- Supply:** Supply Schedule, Curve, and Function
Determinants of, and Changes in, Supply
- Equilibrium:** Excess Demand and Excess Supply
Equilibrium Price and Equilibrium Quantity
- Comparative Statics**
- An Example:** The Money Market

B. The Financial System and Interest Rates

1 The Importance of Money

Empirical Regularities
Functions of Money
Evolution of Exchange Systems
Measurement of Money: Monetary Aggregates

Ch. 1, pp. 9-13 +
Chapter 3

2 The Financial System

Structure of Financial Markets
Financial Intermediaries and Instruments
Regulation of the Financial System
Globalization of Financial Markets

Ch. 1, pp. 1-8 +
Chapter 2

3 Making Sense of Interest Rates

Measurement of Interest Rates:
Present Value, Yield to Maturity, Bond Prices
Interest Rates v. Returns on instruments
Real v. Nominal Interest Rates

Chapter 4

4 How are Interest Rates Determined?

Loanable Funds Framework: The Bond Market
Demand, Supply and Equilibrium
Comparative Statics

Liquidity Preference Framework: The Money Market
Demand, Supply and Equilibrium
Comparative Statics

Chapter 6

- 5 Are Interest Rates Inter-related?** Chapter 7
Risk Structure of Interest Rates
Risk of Default
Liquidity and Tax Considerations
Term Structure of Interest Rates
The Yield Curve
The Expectations Hypothesis

C. Financial Structure and Commercial Banks

- 6 Economic Analysis of Financial Structure** Chapter 9
Empirical Description of the Financial Structure
Transactions Costs, Adverse Selection, and Moral Hazard
Moral Hazard, Debt, and Equity
The Mexican Peso Crisis (Tequila Crisis)

- 7 The Commercial Bank** Chapter 10
The Bank's Balance Sheet
Principles of Bank Management
Bank Failure
The Agency Problem: Barings, Daiwa, and Sumitomo Banks

D. Federal Reserve System and Monetary Policy

- 8 The Federal Reserve System** Chapter 15
Structure: BoG, FOMC, FRB
Boxes 1-6
The Issue of Independence
Foreign Central Banks

- 9 Money Supply: Deposit Creation** Chapter 16
The Fed's Balance Sheet
The Monetary Base
Changing the Monetary Base: OMO, DL, C/D Ratio

- 10 Instruments of Monetary Policy** Chapter 18
Open Market Operations: Properties
Discount Policy: Assessment, Announcement Effect
Reserve Requirements: Assessment, Proposed Reforms

Overview

Addendum

The following is a short list of topics of interest on the institutional aspects of the financial system. Please refer to Chapters 11 – 13 for more details.

- Commercial Banking: Structure and Regulation
- The Federal Deposit Insurance Corporation
- The McFadden Act: Branching Regulations
- The Glass-Steagall Act (Separation Commercial and Securities Trading) and the Financial Services Modernization Act
- Adverse Selection and Moral Hazard in Federal Deposit Insurance
- The S&L Crisis of the 1980s
- The Basle Accord of 1988: Risk-Based Capital Requirements