Monetary Tightening and Global Financial Stability

Recent rate hikes have sent ripples through the global economic landscape, underscoring the critical importance of understanding monetary and fiscal policies. Compared with previous tightening episodes from the German Bundesbank, the ECB has now delivered as much tightening in the space of 15 months as the Bundesbank did from the start of recorded data in 1948. The aim of this seminar is to gain a better understanding of these policies and their impact on financial stability, inflation, and economic growth. Each topic takes a distinct approach, examining issues such as monetary theory, historical contexts, policy debates, and regulatory frameworks.

Topic 1: Monetary Tightening from a Keynesian and Austrian Perspective

This topic takes an excursion into the principles of Austrian Economics and their influence on monetary policy, contrasting them with mainstream new Keynesian approaches.

Blaug, Mark, ed., "The Austrian Theory of Capital and Interest," in Economic Theories in Retrospect (New York: Cambridge University Press, 1997)
Goodfriend, Marvin; King, Robert G (1997), "The New Neoclassical Synthesis and the Role of Monetary Policy", NBER Macroeconomics Annual, NBER Chapters, 12: 231–83,
White, Lawrence. 1989. “What Kinds of Monetary Institutions Would a Free Market Deliver?,” Cato Journal 9 (Fall 1989): 367-91.

Topic 2: Fiscal Dominance vs. Monetary Dominance

De jure, central banks operate independently of fiscal policy. De facto, however, monetary policy has increasingly been subservient to fiscal policy. This makes fiscal dominance a recurring threat to the mission of central banks and to macroeconomic outcomes. This topic explores the complex interplay between fiscal and monetary policy dominance and its implications for financial stability.

Blanchard, Olivier J. "Fiscal dominance and inflation targeting: lessons from Brazil." (2004).
Leeper, Eric M. "Fiscal dominance: How worried should we be." *Policy briefs, Mercatus Center* (2023).
Fratianni, Michele, and Franco Spinelli. "Fiscal dominance and money growth in Italy: the long record." Explorations in Economic History 38, no. 2 (2001): 252-272.

Topic 3: The Fiscal Theory of the Price Level

This topic delves into the relationship between fiscal policy, government debt, and the price level. A particular focus will be placed on Europe’s fiscal challenges in order to understand how government deficits and debt may drive inflation.

Cochrane, John H. *The fiscal theory of the price level*. Princeton University Press, 2023.
Kocherlakota; Phelan (1999). "Explaining the Fiscal Theory of the Price Level" (PDF). Federal Reserve Bank of Minneapolis Quarterly Review.

Topic 4: Ben Strong and the Roaring 1920s: lessons from the History of the Fed

The Fed tightened monetary policy aggressively in 1920 for a familiar reason: to tame inflation. That led to a sharp but relatively short depression. The economy recovered in 1922 only to start overheating in the mid-1920s. This put the Fed in a difficult position. Blamed in part for having caused the depression of 1920 to 1921, Fed leaders feared repeating their mistake and were biased against raising rates prematurely. Complicating matters further, the Fed was under intense pressure from European central bankers to keep rates low. Why? Because if the Fed raised rates, gold would flow from Europe to the United States, as investors sought higher returns on capital. This would threaten post-war reconstruction by reducing the European money supply and forcing European central banks to raise interest rates to stem the outflow of gold.

Friedman, Milton, and Anna Jacobson Schwartz. *The great contraction, 1929-1933*. Princeton University Press, 2008.
Meltzer, A. H. *A History of the Federal Reserve*. Volume 1, 1913–1951. Foreword by Alan Greenspan. Chicago: University of Chicago Press. 2003.

Topic 5: The Volcker Era and Monetary Tightening

This topic analyzes the monetary policies of the Volcker era in the United States and their lessons for contemporary central banking. Volcker's aggressive monetary tightening policies had profound implications for the U.S. economy and set the stage for modern central banking practices. This course explores the challenges, conflicts, and outcomes of the Volcker era, including the clash between the need to curb inflation and concerns about economic growth, unemployment, and financial stability.

Friedman, Benjamin M. "Lessons on Monetary Policy from the 1980s." *Journal of Economic Perspectives* 2, no. 3 (1988): 51-72.
Taylor, John B. "The great inflation, the great disinflation, and policies for future price stability." *Blundell-Wignall, A., ed* (1992).

Topic 6: The "Bubble" and Monetary Tightening in Japan

This course delves into Japan's infamous economic bubble and the subsequent challenges posed by monetary tightening. Focusing on the period of rapid economic growth in the late 1980s and the subsequent burst of the bubble economy, this course examines the intricate relationship between speculative bubbles and monetary policies.

Okina, Kunio, Masaaki Shirakawa, and Shigenori Shiratsuka. "The asset price bubble and monetary policy: Japan's experience in the late 1980s and the lessons." *Monetary and Economic Studies (special edition)* 19, no. 2 (2001): 395-450.
Posen, Adam S. "Why central banks should not burst bubbles." International Finance 9, no. 1 (2006): 109-124.

Topic 7: Global Imbalances and Monetary Tightening

The phenomenon of global imbalances, characterized by disparities in trade surpluses and deficits among countries, has significant implications for the stability of the international monetary system. This topic analyzes how global economic imbalances impact monetary policy, exchange rates, and domestic policies.

Eichengreen,Barry. 2005. "Global Imbalances and the Lessons of Bretton Woods." Federal Reserve Bank of San Francisco, FRBSF Economic Letter 2005-32,
Obstfeld, Maurice, and Kenneth Rogoff. 2010. "Global Imbalances and the Financial Crisis: Products of Common Causes." In Asia and the Global Financial Crisis, ed. Reuven Glick and Mark M. Spiegel. Asia Economic Policy Conference. San Francisco, CA: Federal Reserve Bank of San Francisco 2010.

Topic 8: Monetary Tightening and Uncertainty

This topic focuses on the intricate relationship between monetary tightening and economic uncertainty. Recent economic landscapes have been characterized by heightened uncertainty, influenced by factors such as geopolitical tensions, technological disruptions, and global health crises. This topic delves into how central banks navigate these uncertainties when implementing monetary tightening policies.

Estrella, Arturo, and Frederic S. Mishkin. "Rethinking the role of NAIRU in monetary policy: implications of model formulation and uncertainty." In *Monetary policy rules*, pp. 405-436. University of Chicago Press, 1999.
Greenspan, Alan. "Risk and uncertainty in monetary policy." *American Economic Review* 94, no. 2 (2004): 33-40.
Husted, Lucas, John Rogers, and Bo Sun. "Monetary policy uncertainty." *Journal of Monetary Economics* 115 (2020): 20-36.

Topic 9: Monetary Tightening and Asset Price Bubbles

This course offers an examination of the relationship between monetary tightening and the emergence of asset price bubbles, with a primary focus on housing and stock markets. Students can delve into the dynamics of how changes in monetary policy, such as interest rate hikes and quantitative tightening, can influence asset prices.

Mishkin, Frederic S. "The transmission mechanism and the role of asset prices in monetary policy." (2001).

Topic 10: Monetary Tightening and Expectations Management

This course examines the importance of anchoring inflation expectations and the strategies employed by central banks to maintain price stability in Europe and beyond with a particular view on the challenge provided by heterogenous expectations.

Coibion, Olivier, Yuriy Gorodnichenko, and Saten Kumar. "How do firms form their expectations? new survey evidence." *American Economic Review* 108, no. 9 (2018): 2671-2713.
Weber, Michael, Francesco D'Acunto, Yuriy Gorodnichenko, and Olivier Coibion. "The subjective inflation expectations of households and firms: Measurement, determinants, and implications." *Journal of Economic Perspectives* 36, no. 3 (2022): 157-184.

Topic 11: Quantitative Tightening by Fed, ECB and Bank of Japan

This topic provides an in-depth exploration of Quantitative Tightening (QT) strategies employed by major central banks including the Federal Reserve (Fed), the European Central Bank (ECB), and the Bank of Japan. Focusing on the post-financial crisis era, a focus on the tools, techniques, and implications of QT on the broader economy should be provided.

Neely, Christopher J., and Brett W. Fawley. "Four stories of quantitative easing." (2013).

Topic 12: Regulatory Frameworks and Monetary Tightening

This TOpic explores the relationship between bank regulation, monetary tightening, and the challenges posed by Europe's supervisory mechanisms including the Single Supervisory Mechanism (SSM), Basel III, stress testing, and macroprudential policies. A particular focus will be placed on is the potential conflict of interest between supervisory and monetary policy functions.

Blinder, Alan S. "How central should the central bank be?." *Journal of Economic Literature* 48, no. 1 (2010): 123-133.
N. Nergiz Dincer, Barry Eichengreen, The Architecture and Governance of Financial Supervision: Sources and Implications, International Finance, 10.1111/j.1468-2362.2013.12002.x, 15, 3, (309-325), (2013).