Course Syllabus and Outline

Economics 353, Summer Semester 2004

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Class Webpage: http://www.econ.iastate.edu/classes/econ353/gupta/

Course Description: This course is an eight week introduction to specific issues in banking and finance. The main objectives of this course are to analyze the basic principles of the financial system of the United States and study the agents, markets and institutions that are part of this system. We shall also examine methods (economic policy instruments) by which the activities of agents and institutions in this system might be controlled by the government. Along the way, we will consider the decision problems faced by investors, financial intermediaries, and the central bank and analyze how these players interact to determine allocation of funds, asset prices, and interest rates. We shall survey theoretical models and real-life market situations that will develop our understanding in this regard.

Prerequisites: Economics 101 (Principles of Microeconomics) and Econ 102 (Principles of Macroeconomics).


Limited copies of the textbook shall be available on two-hour loans on weekdays and over weekends from the Parks Library. The Parks library also has copies of this book that are available on extended loan. Till its closure on July 1, copies of the textbook may also be available at the Economics/Sociology Reading Room (3rd floor, Heady Hall). A couple of extra instructor’s personal copies of the textbook might become available. If so, they shall be lent out to students overnight on a first-come-first-serve basis (this is to be coordinated by the TA).

Recommended Resource: Subscription to Aplia.com is strongly recommended. This is the website of Aplia, a company created by the noted economist Prof. Paul Romer of Stanford University. There is a registration fee of $21 for this site. Please see the handout included with this syllabus for registration details. This is a high impact resource that will help improve your understanding of the topics being discussed in class, as well as aid you in preparing for in-class activities. I shall be using materials from this site in my lectures from time to time, and may also use them in my exams. Having access to those materials will help you perform better in class and in exams.
Additional Reading: Since one of the main objectives of the course is to cultivate the ability to think analytically about financial markets and institutions, students are strongly encouraged to become familiar with current policy issues, as discussed in the financial press. The Economist (a weekly magazine) provides an excellent coverage and discussion of current economic and financial events. Some of the articles published weekly in the Economist are freely available at the Economist's home page: http://www.economist.com. Daily coverage can be found in Financial Times: http://news.ft.com/home/us, and the Wall Street Journal: http://online.wsj.com/public/us. On the course website I shall post a list of newspaper/magazine articles relevant to the class. I will regularly recommend articles for you to read as a motivation for upcoming or past course topics. Exams may have bonus questions on certain readings.

Grade Determination: Homework assignments (weight: 40%), Exams (mid-term 1 = 15%, mid-term 2 = 15%, midterm 3 = 15%, final exam = 15%, total weight on exams = 60%). I reserve the right to alter this break-up.

General Comments: Class attendance is strongly encouraged. Please check the course website regularly for announcements and homework assignments. If you are absent from class and miss important announcements, please note that it is your responsibility to find out about them. Feel free to make the best use of my office hours and that of the TAs to clarify your doubts. As this is a compact and intense course, missing classes is not a good idea if you want to do well. As the class will progress at a fast pace and the material is interconnected, you will soon lose track if you do not attend class regularly. It is important to take good notes in class as I will stress on certain portions of the textbook and even add to them. Examination questions will have a strong correlation with the material I shall cover in class. Questions from students during the lecture are always welcome, and a good way to clarify doubts regarding the materials being presented in the lecture. Though most often I shall answer such questions in class, if I face a time constraint I might sometimes defer answering the question till after class on a one-to-one basis. I prefer the class to be interactive, and will surely ask students questions during class in order to gauge the impact of my lectures. You are expected to make your best effort at answering these questions, and understand that this effort is an integral part of your learning process. There is no reason to feel concerned if you answer incorrectly, so long as you make a visible effort. Please also understand that I will expect you to be tolerant of the mistakes your classmates might make during this interactive process.

Homework Policy: Homework deadlines will be strictly enforced, and late submissions shall be allowed only for valid reasons (documented medical or family emergencies). Always remember to put your name and the last five digits of your University ID on your homework. Staple your homework: the TA will not be responsible in case pages go missing from an unstapled homework. There shall be homework solution sessions conducted by Babatunde Abidoye on pre-announced dates, though in case of some homeworks I may just post the solution key on the class webpage. I encourage you to collaborate on the homeworks (and studying for exams), though hopefully such collaboration shall involve a fair division of labor. I shall break up the class into study
groups during the second week to facilitate this. However, separate homeworks must be submitted by each student.

**Make-up Policy:** There will be no make-up exams in case of unexcused absences. Unexcused absences will earn a zero on the concerned exam. Only one make-up exam will be offered per student during the semester for valid excuses (university approved medical or family emergencies). If you miss one exam due to a valid reason, I shall re-weight the other exams to make up for it. If you miss two exams for valid reasons, you will have an opportunity to appear in a make-up exam no later than two weeks from the date of the final exam, or take an incomplete on the course. You will need to take at least three exams to get a grade on this course.

**Academic Integrity:** The rules of academic integrity will be enforced in this class. Please see the relevant university guidelines in this regard.

**Disability Requirements:** If you have a disability and require accommodations, please contact me early in the semester so that your learning needs may be appropriately met. You will need to provide documentation of your disability to the Disability Resources (DR) office, located on the main floor of the Student Services Building, Room 1076, 515-294-6624.

**Course Outline** (tentative):

Topic/Chapters (in sequence they shall be introduced in class)

- **Part I: An Overview of Financial Markets and Institutions**
  1. Why Study Money, Banking, and Financial Markets? Ch. 1
  2. Overview of the Financial System Ch. 2
  3. What is Money? Ch. 3
- **Part II: Investing**
  4. Discounting: How should one compare payments expected at different points in time? Ch. 4
  5. Portfolio Choice: How should one select an asset under uncertainty? Notes

**MIDTERM EXAM I** – Ch. 1-4, Notes on Portfolio Choice

- **Part III: Financial Markets**
  6. What determines the overall level of interest rates? Ch. 5
  7. The Risk and Term Structure of Interest Rates:

  - What determines the spread between corporate, municipal and Treasury bonds?


What determines the spread between government bond yields of different maturities? Ch. 6
8. What drives the movement of stock prices over time? Ch. 7
9. The Foreign Exchange Market and the International Financial System Ch. 19, 20
10. Financial Derivatives: What are futures, options and why are they useful? Ch. 13

MIDTERM EXAM II – Ch. 5 - 7, 13, 19, and 20

Part IV: Financial Institutions
11. The role of asymmetric information in financial intermediation Ch. 8
12. Commercial Banking: What are the main activities of bank managers? Ch. 9
13. Structure, Competition and Regulation in Banking: Main developments and current trends Ch. 10, 11
14. Non-Bank Financial Institutions Ch. 12

Part V: Central Banking and the Conduct of Monetary Policy
15. Structure of Central Banks and the Federal Reserve System Ch. 14

MIDTERM EXAM III - Ch. 8 – 12, and 14
16. Multiple Deposit-Creation Ch. 15
17. Determinants of Money Supply Ch. 16
18. Monetary Policy
   · What options to control money supply are available to the Fed?
   · How is monetary policy conducted in practice? Ch. 17, 18

FINAL EXAM- Ch. 15-18