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Monetary Policy: Theory and Practice

Advanced Studies Program

Kiel Institute for the World Economy

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Course Overview, Objective and Background Readings

The objective of this course is to provide an introduction to the analysis of monetary policy making with practical applications to current policy challenges. Examples from the European Union, the United States and Japan will be discussed. We will develop theoretical models of monetary policy and learn how different policy recommendations can be evaluated using these models. Interest rate policy will be studied as well as quantitative easing and tightening. We will also look at monetary-fiscal interactions and discuss the role of the financial sector and financial frictions in monetary policy transmission. Students will conduct practical simulation exercises and make use of software tools for model analysis. In particular, we will analyse policy working with macro-financial models available in the Macroeconomic Model Database (see www.macromodelbase.com). Given time, we will also consider policy responses during the coronavirus pandemic and how to include epidemics in macro models drawing on the Epi-Macro-Model Database (see www.epi-mmb.com).

The following lists summarize the main topics of the lectures and the relevant background readings. Further details regarding the schedule, slides and handouts will be provided during the course.

Outline:

1. Macro fluctuations and policy responses 2000–23: A brief tour
2. The inflation surge of 2021-23 and the Taylor principle
3. Monetary policy rules and model uncertainty
4. Inflation targeting and optimal control
5. Optimal policy in a New Keynesian model
6. The effective lower bound on nominal rates: From QE to QT
7. Monetary-fiscal interactions: Fiscal multipliers, government budget constraints and monetary policy
8. The financial accelerator, housing and banking frictions

Background Readings:

Book Chapters:

Cochrane, J.H., J. B. Taylor and V. Wieland, [Evaluating Rules in the Fed's Report and Measuring Discretion](#), in: John H. Cochrane and John B. Taylor (eds.), *Strategies for Monetary Policy*, Hoover Institution Press, May 2020.

Reis, R. (2022) „The burst of high inflation in 2021/22: How and why did we get here?“ and Wieland V. (2022) Discussion, in Bordo, Cochrane, Taylor (2022) „[How monetary policy got the behind the curve – and how to get back](#)“, pp. 203-250.

Schmidt, S. and Wieland, V. (2013), “The New Keynesian Approach to Dynamic General Equilibrium Modeling: Models, Methods and Macroeconomic Policy Evaluation”, [Handbook of Computable General Equilibrium Modeling](#), Vol. 1B, Elsevier.

Walsh, C. (2010). [Monetary Theory and Policy](#), MIT Press, 3rd edition, Chapter 8: New Keynesian Monetary Economics.
Chapter 4: Money and Public Finance.

Wieland, V., (Editor), [The Science and Practice of Monetary Policy Today](#), Springer Science, 2009, ISBN: 978-3-642-02952-3, Chapters 1, 2, 3 and 5.

Wieland, V., Afanasyeva, E., Kuete, M. and Yoo, J. (2016), “New Methods for Macro-Financial Model Comparison and Policy Analysis,” in John B. Taylor and Harald Uhlig (eds.), [Handbook of Macroeconomics: Vol 2](#), North Holland/Elsevier, 2016.

Wieland, V. and Wolters, M. (2013), “Forecasting and Policy Making”, in, Elliott, G. and A. Timmermann (eds.), [Handbook of Economic Forecasting](#), Vol. 2, Elsevier.

Journal Articles and Working Papers:

Beck, G. and Wieland V. (2008), “Central Bank Misperceptions and the Role of Money in Interest Rate Rules”, [Journal of Monetary Economics](#), 55 (S1), p. S1-S17, October.

Beyer, R. and V. Wieland (2019), “Instability, Imprecision and Inconsistent use of Equilibrium Real Interest Rate Estimates” [Journal of International Money and Finance](#), 2019, 94, pp. 1-14.

Clarida, R., Gali, J. and Gertler, M. (1999). "The Science of Monetary Policy: A New Keynesian Perspective," [Journal of Economic Literature](#), American Economic Association, 37(4), p. 1661-1707, December.

Cogan, J.F., Taylor, J.B., Wieland, V. and Wolters, M. (2013), “Fiscal Consolidation Strategy”, Journal of Economic Dynamics and Control, 37, p. 404 – 421, February.

Coenen, G., McAdam, P. and Straub, R. (2008), “Tax Reform and Labour-Market Performance in the Euro Area: A Simulation-Based Analysis Using the New Area-Wide Model”, Journal of Economic Dynamics and Control, 32(8), p. 2543-2583.

Coenen, G., Orphanides, A. and Wieland, V. (2004), “Price Stability and Monetary Policy Effectiveness when Nominal Interest Rates are Bounded at Zero”, Advances in Macroeconomics, 4(1), Art. 1, January.

Cogan, J., Cwik, T., Taylor, J.B. and Wieland, V. (2010), “New Keynesian versus Old Keynesian Government Spending Multipliers”, Journal of Economic Dynamics and Control, 34(3), p. 281-295, March.

Eichenbaum, M.S., Rebelo, S. and Trabandt, M., (2020), „The Macroeconomics of Epidemics,“ The Review of Financial Studies, Volume 34, Issue 11, November 2021, Pages 5149–5187.

Eichenbaum, M.S., Rebelo, S. and Trabandt, M., (2022), „Epidemics in the New Keynesian Model,“ Journal of Economic Dynamics and Control, Volume 140, July 2022.

Feld, L. and V. Wieland, (2020), “The German Federal Constitutional Court Ruling and the European Central Bank Strategy”, Journal of Financial Regulation, Volume 7, Issue 2, October 2021, Pages 217–253.

Grimm, V., L. Nöh, and V. Wieland (2023), “[Government bond rates and interest expenditure of large euro area member states: A scenario analysis](#)”, International Finance, July 2023.

Kuester, K. and Wieland, V. (2010), “Insurance Policies for Monetary Policy in the Euro Area”, Journal of the European Economic Association, 8(4), p. 872-912.

Orphanides, A. and Wieland, V. (2013), “Complexity and Monetary Policy”, International Journal of Central Banking, 9(S1), p. 167-204, January.

Orphanides, A. and Wieland, V. (2000), “Efficient Monetary Policy Design Near Price Stability”, Journal of the Japanese and International Economies, 14, p. 327-365.

Svensson, L. (1997), ”Inflation Forecast Targeting: Implementing and Monitoring Inflation Targets”, European Economic Review, 41, p. 1111-1146.

Taylor, J.B. and Wieland, V. (2012), “Surprising Comparative Properties of Monetary Models: Results from a New Monetary Model Base”, [Review of Economics and Statistics](#), 94, p. 800-816.

Woodford, Michael (2010), “Simple Analytics of the Government Spending Multiplier”, [American Economic Journal: Macroeconomics](#), American Economic Association, 3(1), p. 1-35, January.

Wieland, Volker (2010), “Quantitative Easing: A Rationale and some Evidence from Japan”, in Reichlin, Lucrezia and Kenneth West (eds.), [NBER International Seminar on Macroeconomics 2009](#), NBER and University of Chicago Press.

Wieland, V., Cwik, T., Mueller, G., Schmidt, S. and Wolters, M. (2012), “A New Comparative Approach to Macroeconomic Modelling and Policy Analysis”, [Journal of Economic Behavior and Organisation](#), 83, p. 523-541, August.

Wieland, V. (2020), “The Decline in Euro Area Inflation and the Choice of Policy Strategy,” [Sintra Conference 2020, European Central Bank](#), working paper, December 2020.

Wieland, V. (2023), [Discussion of "policy packages and policy space: Lessons from COVID-19"](#) by Bergant and Forbes, [European Economic Review](#), Vol. 158, September 2023