

Contents

<i>List of figures and table</i>	<i>page</i> vii
<i>The Raffaele Mattioli Lectures</i>	xi
<i>Preface</i>	xiii
Part I The principles of the new paradigm	1
1 Reflections on the current state of monetary economics	7
2 How finance differs	26
3 The ideal banking system	43
4 Restricted banking (or, the banking system of today)	90
5 Market equilibrium	104
6 From the corn economy to the monetary economy	117
7 Towards a general equilibrium theory of credit	137
Part II Applications of the new paradigm	151
8 Monetary policy	154
9 Regulatory policy and the new paradigm	203
10 Financial market liberalization	234
11 Restructuring the banking sector	239
12 Regional downturns and development and monetary policy	251

13	The East Asia crisis	261
14	The 1991 US recession and the recovery	276
15	The new paradigm and the “new economy”	284
16	Concluding remarks	293
	<i>Bibliography</i>	303
	<i>Index</i>	320

Figures and table

FIGURES

1.1 Average annual yield rates for 3-month T-bills and a cash management account, 1992–2001	<i>page</i> 13
1.2 Stock value traded as a percentage of GDP, various countries	15
1.3 Velocity	17
1.4 Regression of velocity on nominal interest rates	18
1.5 Movements in real interest rates	23
2.1 The interest rate which maximizes expected return to the bank	28
2.2 Effect of recession on real lending interest rates	32
2.3 The optimal interest rate charged by one bank may depend on that charged by others	33
2.4 Effect of recession on aggregate demand and supply curves	41
2.5 Junk Treasury spread, 1988–2000	42
3.1 Loanable funds model, no credit rationing	45
3.2 Loanable funds model with credit rationing	47
3.3 Impact of changing economic conditions on the equilibrium interest rate with credit rationing	48
3.4 Determining the equilibrium lending activity with bankruptcy	57

3.5	Traditional model with no bankruptcy	58
3.6	Interest rate determination with credit rationing and bankruptcy	59
3.7	Loan opportunity set (mean–standard deviation frontier)	63
3.8	Mean–variance model with interest rate fixed and variable	64
3.9	Mean–variance model, credit rationing, with and without reserve requirement	65
3.10	Mean–variance model, credit rationing, diminishing returns to lending	67
3.11	Mean–variance model, no credit rationing	68
3.12	Effects of change in cost of capital when there are two or more groups in the population	73
3.13	Impact of lower bank wealth on interest rate charged, bankruptcy model	75
3.14	Impact of lower bank wealth, mean–variance model	76
3.15	Impact of mean–preserving spread (increase in risk) of the borrower’s return on lending, bankruptcy	79
3.16	Effect of mean-preserving increase in risk	80
3.17	Impact of increase in reserve requirements, bankruptcy model	82
3.18	Impact of increase in reserve requirements, mean–variance model	82
3.19	Impact of increase in interest rates	84
3.20	Impact of increase in capital adequacy requirements	85
3.21	Impact of capital adequacy requirements	87
4.1	Opportunity locus, mean–variance model, restricted banking	97
4.2	Impact of reduced bank wealth, restricted banking	98
4.3	Impact of increased interest rates, restricted banking	100
4.4	Impact of increased reserve requirements	102
5.1	Equilibrium interest rate in the corn economy	115

6.1	Monetary equilibrium	124
6.2	Shift of $IS-L^*M^*$ curves within business cycles	126
6.3	Open market operations	129
7.1	General equilibrium credit relations model	139
7.2	Model of credit interlinkages with three firms	143
8.1	General equilibrium effects of an increase in reserve requirements	159
8.2	Impact of higher opportunity cost of funds (expected rate of return on lending rates charged)	161
8.3	Impact of increased reserve requirements, credit rationing with excess liquidity	163
8.4	Asset effect of monetary policy	169
8.5	Risk effect of monetary policy loans marketable	172
8.6	Risk effect of monetary policy, no secondary market for loans	173
8.7	Impacts of monetary policy on aggregate demand and supply	182
8.8	Liquidity trap, traditional version	188
8.9	Liquidity trap, new version	189
8.10	Liquidity trap, corner solution	190
8.11	How lowering interest rates can sometimes have large positive effects	191

TABLE

12.1	Regression results, industry percentage growth in employment by state in each year	255
------	---	-----