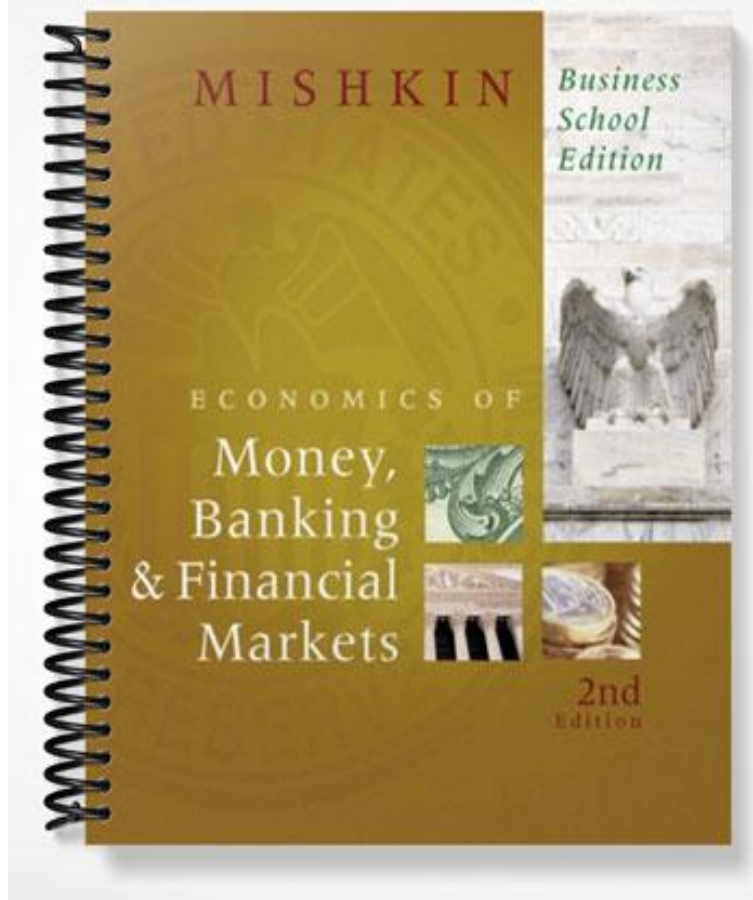


SOLUTIONS MANUAL



PART ONE

How to Use the Instructor's Manual and Other Textbook Ancillaries

Organization of the Instructor's Manual

To help instructors cope with the increased demands for good teaching in recent years, *The Economics of Money, Banking, and Financial Markets*, Business School Edition, includes the most comprehensive package of supplementary materials of any money, banking, and financial markets textbook. As part of these supplemental materials, I have designed the Instructor's Manual to help save you time in preparing class materials, such as class outlines, solutions to homework problems, lecture notes, and overhead transparencies.

This Instructor's Manual is divided into four parts. Part One discusses how to use the Instructor's Manual and the other textbook ancillaries to make your teaching of the money and banking course both more effective and less time-consuming. Part Two contains an overview of all the textbook chapters along with teaching tips that I have found effective. Part Three contains the answers to the end-of-chapter problems that are not answered in the back of the textbook, and so are excellent candidates for assignment as problem sets. Part Four contains transparency masters of chapter outlines, which can be used either to make overhead transparencies for use in class or to make handouts for the students.

To obtain any of the available ancillaries, adopters of the text just need to get in touch with their Pearson sales representative, or alternatively they can make an e-mail request at econ@pearson.com or visit the Instructor's Resource Center at <http://www.pearsonhighered.com/irc>.

Alternative Course Outlines

There are many different ways to teach a course on money, banking, and financial markets. For this reason, the material in *The Economics of Money, Banking, and Financial Markets*, Business School Edition, has been arranged with flexibility in mind, so that many teaching styles can be accommodated. The following sections suggest sample outlines for four main approaches to teaching money, banking, and financial markets, showing how the text can be adapted to each approach, as well as to quarter and semester teaching schedules. Note, however, that many variations on these outlines are possible.

■ Outline for General Money and Banking Course

Core Chapters

Chapter No. Chapter Title

1. Why Study Money, Banking, and Financial Markets?
2. An Overview of the Financial System
3. What Is Money?
4. Understanding Interest Rates
5. The Behavior of Interest Rates
10. Banking and the Management of Financial Institutions
11. Economic Analysis of Financial Regulation
12. Banking Industry: Structure and Competition
16. Central Banks and the Federal Reserve System
18. Tools of Monetary Policy
19. The Conduct of Monetary Policy: Strategy and Tactics
23. Aggregate Demand and Supply Analysis
25. Money and Inflation

For a one-semester course, cover any six of the following optional chapters:

Chapter No. Chapter Title

6. The Risk and Term Structure of Interest Rates
7. The Stock Market, the Theory of Rational Expectations, and the Efficient Markets Hypothesis
8. An Economic Analysis of Financial Structure
9. Financial Crises and the Subprime Meltdown
13. Nonbank Finance
14. Financial Derivatives
15. Conflicts of Interest in the Financial Industry
17. The Money Supply Process
20. The Foreign Exchange Market
21. The International Financial System
22. The Demand for Money
24. Transmission Mechanisms of Monetary Policy: The Evidence

A one-quarter course would probably only include one or two of the optional chapters unless some of the chapters on central banking and the conduct of monetary policy (Chapters 16, 18, and 19) were deleted.

■ Outline for General Money and Banking Course with an International Emphasis

Core Chapters

Chapter No.	Chapter Title
-------------	---------------

- | | |
|-----|--|
| 1. | Why Study Money, Banking, and Financial Markets? |
| 2. | An Overview of the Financial System |
| 3. | What Is Money? |
| 4. | Understanding Interest Rates |
| 5. | The Behavior of Interest Rates |
| 10. | Banking and the Management of Financial Institutions |
| 11. | Economic Analysis of Financial Regulation |
| 12. | Banking Industry: Structure and Competition |
| 16. | Central Banks and the Federal Reserve System |
| 18. | Tools of Monetary Policy |
| 19. | The Conduct of Monetary Policy: Strategy and Tactics |
| 20. | The Foreign Exchange Market |
| 21. | The International Financial System |
| 23. | Aggregate Demand and Supply Analysis |
| 25. | Money and Inflation |

For a one-semester course, cover any four of the following optional chapters:

Chapter No.	Chapter Title
-------------	---------------

- | | |
|-----|---|
| 6. | The Risk and Term Structure of Interest Rates |
| 7. | The Stock Market, the Theory of Rational Expectations, and the Efficient Markets Hypothesis |
| 8. | An Economic Analysis of Financial Structure |
| 9. | Financial Crises and the Subprime Meltdown |
| 13. | Nonbank Finance |
| 14. | Financial Derivatives |
| 15. | Conflicts of Interest in the Financial Industry |
| 17. | The Money Supply Process |
| 22. | The Demand for Money |
| 24. | Transmission Mechanisms of Monetary Policy: The Evidence |

A one-quarter course would probably not include any other chapters unless some of the chapters on central banking and the conduct of monetary policy (Chapters 16, 18, and 19) were deleted.

■ Outline for Financial Markets and Institutions Course

Core Chapters

Chapter No.	Chapter Title
1.	Why Study Money, Banking, and Financial Markets?
2.	An Overview of the Financial System
3.	What Is Money?
4.	Understanding Interest Rates
5.	The Behavior of Interest Rates
6.	The Risk and Term Structure of Interest Rates
7.	The Stock Market, the Theory of Rational Expectations, and the Efficient Markets Hypothesis
8.	An Economic Analysis of Financial Structure
9.	Financial Crises and the Subprime Meltdown
10.	Banking and the Management of Financial Institutions
11.	Economic Analysis of Financial Regulation
12.	Banking Industry: Structure and Competition
13.	Nonbank Finance
14.	Financial Derivatives
15.	Conflicts of Interest in the Financial Industry

For a one-semester course, cover any four of the following optional chapters:

Chapter No.	Chapter Title
16.	Central Banks and the Federal Reserve System
17.	The Money Supply Process
18.	Tools of Monetary Policy
19.	The Conduct of Monetary Policy: Strategy and Tactics
20.	The Foreign Exchange Market
21.	The International Financial System
22.	The Demand for Money
23.	Aggregate Demand and Supply Analysis
24.	Transmission Mechanisms of Monetary Policy: The Evidence
25.	Money and Inflation

A one-quarter course would probably only include one of the optional chapters.

■ Outline for Monetary Theory and Policy Course

Core Chapters

Chapter No.	Chapter Title
-------------	---------------

- | | |
|-----|--|
| 1. | Why Study Money, Banking, and Financial Markets? |
| 2. | An Overview of the Financial System |
| 3. | What Is Money? |
| 4. | Understanding Interest Rates |
| 5. | The Behavior of Interest Rates |
| 16. | Central Banks and the Federal Reserve System |
| 17. | The Money Supply Process |
| 18. | Tools of Monetary Policy |
| 19. | The Conduct of Monetary Policy: Strategy and Tactics |
| 23. | Aggregate Demand and Supply Analysis |
| 24. | Transmission Mechanisms of Monetary Policy: The Evidence |
| 25. | Money and Inflation |

For a one-semester course, cover any seven of the following optional chapters:

Chapter No.	Chapter Title
-------------	---------------

- | | |
|-----|---|
| 6. | The Risk and Term Structure of Interest Rates |
| 7. | The Stock Market, the Theory of Rational Expectations, and the Efficient Markets Hypothesis |
| 8. | An Economic Analysis of Financial Structure |
| 9. | Financial Crises and the Subprime Meltdown |
| 10. | Banking and the Management of Financial Institutions |
| 11. | Economic Analysis of Financial Regulation |
| 12. | Banking Industry: Structure and Competition |
| 13. | Nonbank Finance |
| 14. | Financial Derivatives |
| 15. | Conflicts of Interest in the Financial Industry |
| 20. | The Foreign Exchange Market |
| 21. | The International Financial System |
| 22. | The Demand for Money |

A one-quarter course would probably only include three or four of the optional chapters.

Overviews of the Textbook Chapters and Teaching Tips

I have been teaching money and banking now for over twenty years. The overviews and teaching tips in Part Two of the Instructor's Manual are intended to share with you some of my experiences in the classroom with teaching the material in the textbook. The overview and teaching tips for each chapter provide a brief description of the contents of the chapter, discuss the novel features of the chapter, indicate what central points need to be transmitted to the student, suggest teaching tips that I have found useful in class, and provide guidance as to what material can easily be skipped in each chapter.

Answers to End-of-Chapter Problems

Part Three of the Instructor's Manual contains the answers to end-of-chapter. Some of these questions require students to look up current data, and in these cases no answers are given; however, for the rest of the questions, the answers are quite complete.

Many instructors will use the end-of-chapter questions for homework assignments, as I do. I have found it useful to hand out answers to the questions provided in Part Three to the students as solutions sets after they have completed their assignments; they find them to be an invaluable study aid. Making up these solution sets for reproduction should be quite easy, either by cutting and pasting from Part Three, using the files on the Instructor's Resource CD-ROM, or downloading the files from the Instructor's Resource Center at www.pearsonhighered.com/irc.

PowerPoint Presentation

Also offered in the instructor supplement's package is a PowerPoint Presentation that contains lecture notes and all the textbook's figures and tables. These slides are comprehensive and outline all the major points covered in the text. The lecture notes have been class-tested successfully—they are the ones that I use in class—and they should help other instructors prepare their lectures as they have helped me.

Please note that unless you have access to PowerPoint version 4.0 or higher you will only be able to project the provided images using the viewer that is included; editing or adding material will not be possible unless you have the software program.

To obtain Instructor's Resource Disk (with PowerPoint files), adopters of the text just need to get in touch with their Pearson sales representative, send an e-mail request to econ@pearson.com or visit the Instructor's Resource Center at www.pearsonhighered.com/irc to download the available electronic files.

Instructor's Resource CD-ROM (With Electronic Files of the Instructor's Manual, Test Bank, and PowerPoint Presentation)

To instructors who adopt the money and banking textbook, Pearson offers an Instructor's Resource CD-ROM, housing on one convenient disk the files for this Instructor's Manual (including the full set of lecture notes, modifiable to the instructor's needs). Also featured on the CD are the complete electronic test bank files in TestGen format and a PowerPoint Presentation featuring all the textbook's figures and tables. To obtain a copy of this indispensable teaching aid, contact your local sales representative or send an e-mail request to econ@pearson.com. All instructor resources may also be downloaded from the Instructor's Resource Center at www.pearsonhighered.com/irc.

Printed and Computerized Test Bank

The Test Bank, by Kathy Kelly of the University of Texas, Arlington, and Richard Stahl of Louisiana State University, contains over 2,500 multiple-choice questions, many with graphs, that are appropriate for use as quiz or test questions. It is provided as a separate paperback book and alternatively in Macintosh and Windows versions on the Instructor's Resource CD-ROM. It can also be downloaded from the Instructor's Resource Center at www.pearsonhighered.com/irc. These various forms provide alternative methods for the instructor to make up exams.

The Pearson TestGen program offered is a computerized test generator that lets you construct tests by choosing questions from the item bank that was prepared specifically for this textbook and your course. The test construction process involves the use of a simple TestGen screen that you fill in on the computer to choose questions for your test. If desired, test questions can be viewed on the screen, and test questions can be edited, saved, or printed. In addition, you can add questions, which may include graphics.

The program features:

- Test and item banks can include five types of question types: multiple choice; true/false; short answer; and essay.

- A supplementary page attached to each item bank question can contain its topic, objective, skill, difficulty, and other user-added information.

- Test questions can be chosen in a variety of ways including manual selection, random selection, choose while viewing, and choose by searching.

- Questions chosen for a test can be viewed and edited without affecting the original versions of the questions in the item bank.

- Test size is limited only by the memory size of the computer and the length of the questions you choose.

- Test questions can be printed in the exact order you specify or grouped and sorted automatically by the program.

- Printer files can be created or modified to take advantage of the capabilities of your printer.

Course Management with MyEconLab

Every student who buys a new textbook receives a prepaid subscription to MyEconLab. MyEconLab delivers rich online content and innovative learning tools to your classroom. Instructors who use MyEconLab gain access to powerful communication and assessment tools, and their students receive access to the additional learning resources described below.

Students and MyEconLab

MyEconLab delivers the content and tools your students need to succeed online, and is also available within Pearson's innovative CourseCompass system for instructors who choose to use it. Students whose instructors use MyEconLab gain access to a variety of study and practice tools that put them in control of their own learning:

- Practice tests enable students to check their understanding and identify areas in which they need to do further work.
- A personalized study plan based on test results will show students where further study is needed.
- Interactive exercises based on specific end-of-chapter questions as well as general topics allow the student to review the material at any time. Some exercises require students to draw a graph. See the preface to the textbook to view sample exercises.
- The textbook online, with animations of key figures.
- A selection of *Readings in Money, Banking, and Financial Markets*, regularly updated by me and James W. Eaton of Bridgewater College, provides current articles related to topics covered in the textbook.
- Each week during the semester, students will be asked to read an article from a major online news source and answer questions on it. This is an effective and natural way to bring current events into the classroom.
- Sample quizzes give students a chance to double-check their understanding and application of the main topics in each test chapter.
- Supplements to the textbook, such as chapter synopses, glossary flashcards, and links to other Web sites, help instructors to expand on the material.
- Users of the CourseCompass system will have access to Research Navigator™—a one-stop research tool, with extensive help on the entire research process, including evaluating sources, drafting, and documentation, as well as access to a variety of scholarly journals and publications, a complete year of search for full-text articles from *The New York Times*, and a “Best of the Web” Link Library of peer-reviewed Web sites.

The Student Access Kit that arrives bundled with all new books walks students step-by-step through the registration process.

Instructors and MyEconLab

With MyEconLab instructors can customize existing content and add their own. They can manage, create, and assign tests to students, choosing from the exercises in the Study Plan as well as from our Test Banks. MyEconLab also includes advanced tracking features that record students' usage and performance and a Gradebook feature to see students' test results. Choosing to use MyEconLab in CourseCompass provides an instructor with even more tools for customization and class communication. Please contact your Pearson sales representative to find out which version of MyEconLab is right for your course.

The Mishkin Companion Web Site

For those students who buy used textbooks and choose not to purchase access to MyEconLab, the companion Web site for *The Economics of Money, Banking, and Financial Markets*, Business School Edition, at www.pearsonhighered.com/mishkin, offers a brief chapter preview, a review quiz, links to related Web sites, and glossary flashcards. Premium features such as the electronic textbook and interactive exercises are only available via MyEconLab.

Readings in Money, Banking, and Financial Markets **(Online Reader)**

A basic problem of textbooks in the money and banking field is that current events and financial innovation make many of the facts in the textbook obsolete soon after publication. To minimize this problem, *The Economics of Money, Banking, and Financial Markets*, Business School Edition, focuses less on a set of facts, but rather stresses the underlying principles to understand money, banking, and financial markets. The advantage to this approach is that these principles never become obsolete, and as a result, the material in the text continues to promote understanding of the financial system as it evolves over time.

Because of the emphasis on basic principles, the text works extremely well when it is supplemented by current readings on banking and financial markets. To make it easy for instructors to supplement the text with current readings, Pearson publishes an annual *Readings* book online, designed to supplement the text and edited by James W. Eaton of Bridgewater College and myself. The *Readings* collection is unique in that it is updated over the life of this edition of the textbook, with well over half of the articles new with each update. In addition, it includes summaries of the articles, provides suggestions for which textbook chapter(s) the reading might be assigned, and contains discussion questions that follow each reading in order to encourage students to think about how the reading relates to material in the text. The *Readings* should enable instructors to keep the subject matter of their course current throughout the life of the edition of the text.

To provide you with a better feel for what the Readings comprise, the table of contents from the 2007 edition is provided on the next several pages.

Year 2007 Readings for Money, Banking, and Financial Markets*

Reading 1

“Evaluating the Relative Strength of the U.S. Capital Markets”
Stavros Peristiani

Reading 2

“The Fate of One-Dollar Coins in the U.S.”
Sébastien Lotz and Guillaume Rocheteau

Reading 3

“Are Consumers Cashing Out?”
Paul W. Bauer and Daniel Littman

Reading 4

“Investment Improvement: Adding Duration to the Toolbox”
Michelle Clark Neely

Reading 5

“Inflation Expectations: How the Market Speaks”
Simon Kwan

Reading 6

“Globalization’s Effect on Interest Rates and the Yield Curve”
Tao Wu

Reading 7

“The Yield Curve as a Leading Indicator: Some Practical Issues”
Arturo Estrella and Mary R. Trubin

Reading 8

“Asset Price Bubbles”
Kevin J. Lansing

Reading 9

“For Better and For Worse: Three Lending Relationships”
Mitchell Berlin

Reading 10

“Dancing with Wolves: Syndicated Loans and the Economics of Multiple Lenders”
Mitchell Berlin

* Please note that these are from the 2007 Reader to give you a feel for the type of articles chosen. The 2010 reading selections are available in MyEconLab at www.myeconlab.com/mishkin. Articles will also be updated periodically.

Reading 11

“The Role of Relationships in Small-Business Lending”
Ben R. Craig, William E. Jackson III, and James B. Thomson

Reading 12

“Going Private”
Vanessa Sumo

Reading 13

“Perils of Price Deflation: An Analysis of the Great Depression”
Charles T. Carlstrom and Timothy S. Fuerst

Reading 14

“How Financial Firms Manage Risk”
Jose A. Lopez

Reading 15

“Industrial Loan Companies Come Out of the Shadows”
Michelle Clark Neely

Reading 16

“The Rise and Fall of Subprime Mortgages”
Danielle DiMartino and John V. Duca

Reading 17

“Branch Bonanza”
Doug Campbell

Reading 18

“Bank Diversification, Economic Diversification?”
Philip E. Strahan

Reading 19

“Banking Consolidation”
Simon Kwan

Reading 20

“Two Faces of Banking”
Klimentina Poposka, Mark D. Vaughan, and Timothy J. Yeager

Reading 21

“Credit Unions Make Friends—But Not with Bankers”
William R. Emmons and Frank A. Schmid

Reading 22

“Competition and Opportunity: How International Forces Spurred Innovation in U.S. Banking?”
Richard N. Cooper and Jane Little

Reading 23

“Federal Preemption of State Bank Regulation: A Conference Panel Summary”
Erin Davis and Tara Rice

Reading 24

“Why Economists Still Worry About Bank Runs”
Doug Campbell

Reading 25

“Managing the Expanded Safety Net”
Gary H. Stern and Ron J. Feldman

Reading 26

“Central Bank Independence: The Key to Price Stability?”
Charles T. Carlstrom and Timothy S. Fuerst

Reading 27

“Explaining Bank Credit Crunches and Procyclicality”
Robert R. Bliss and George G. Kaufman

Reading 28

“Right on Target”
Phil Davies

Reading 29

“Fed to Begin Paying Interest on Reserves”
John Walter and Patricia Wescott

Reading 30

“Liquidity Crises”
Ronel Elul

Reading 31

“U.S. Monetary Policy: An Introduction. Part 2: What Are the Goals of U.S. Monetary Policy?”
Federal Reserve Bank of San Francisco *FRBSF Economic Letter*

Reading 32

“U.S. Monetary Policy: An Introduction. Part 4: How Does the Fed Decide the Appropriate Setting for the Policy Instrument?”
Federal Reserve Bank of San Francisco *FRBSF Economic Letter*

Reading 33

“Uncertainty and Monetary Policy”
Richard Dennis

Reading 34

“Publishing Central Bank Interest Rate Forecasts”
Glenn D. Rudebusch

Reading 35

“The Taylor Rule: A Guidepost for Monetary Policy?”
Charles T. Carlstrom and Timothy S. Fuerst

Reading 36

“What is the Right Inflation Rate?”
David E. Altig

Reading 37

“Reflections on Monetary Policy: Flexibility, Transparency, and Inflation”
Michael H. Moskow

Reading 38

“Would an Inflation Target Help Anchor U.S. Inflation Expectations?”
Eric Swanson

Reading 39

“Inflation Targets and Inflation Expectations: Some Evidence from the Recent Oil shocks”
Bharat Trehan

Reading 40

“Should the Fed React to the Stock Market?”
Kevin J. Lansing

Reading 41

“Burger Survey Provides Taste of International Economics”
Michael R. Pakko and Patricia S. Pollard

Reading 42

“Interest Rates, Carry Trades, and Exchange Rate Movements”
Michele Cavallo

Reading 43

“On the Rotation of the Earth, Drunken Sailors, and Exchange Rate Policy”
Owen F. Humpage

Reading 44

“Global Risks to U.S. Monetary Policy”
Owen F. Humpage

Reading 45

“Sovereign Wealth Funds: Stumbling Blocks or Stepping Stones to Financial Globalization?”
Joshua Aizenman and Reuven Glick

Reading 46

“Spendthrift Nation”
Kevin J. Lansing

Reading 47

“Deficit-Financed Tax Cuts and Interest Rates”
Sylvain Leduc

Reading 48

“What Accounts for the Postwar Decline in Economic Volatility?”
Keith Sill

Reading 49

“The Great Moderation: Good Luck, Good Policy, or Less Oil Dependence?”
Andrea Pescatori

Reading 50

“U.S. Monetary Policy: An Introduction. Part 3: How Does Monetary Policy Affect the U.S. Economy?”
Federal Reserve Bank of San Francisco *FRBSF Economic Letter*

Reading 51

“Why Policymakers Might Care about Stock Market Bubbles”
Paul Gomme

Reading 52

“Stock Prices and Output Growth: An Examination of the Credit Channel”
Charles T. Carlstrom, Timothy S. Fuerst, and Vasso P. Ioannidou

Reading 53

“Inflation, Banking, and Economic Growth”
John H. Boyd and Bruce Champ

Reading 54

“Sticky Situation”
Doug Campbell

Reading 55

“Activist Monetary Policy For Good or Evil? The New Keynesians vs. the New Classics”
Tom Stark and Herb Taylor

Study Guide

The only way to learn effectively about money, banking, and financial markets is by continual, and active, application of the basic concepts developed in the textbook. To help the student in this endeavor, Edward Gamber of Lafayette College and David Hakes of the University of Northern Iowa have written the *Study Guide*.

The *Study Guide* contains the following elements for each chapter:

Chapter Review:

Each chapter begins with a summary of the chapter. The chapter review is divided into sections based on the section headings provided in the text.

Helpful Hints:

This section provides some additional suggestions and examples to help clarify the more difficult material.

Terms and Definitions:

Students match key terms from the text to their definitions. This section is particularly important because a working economic and financial vocabulary is necessary in order for the student to advance through the material.

Problems and Short-Answer Questions:

We provide a number of multi-step problems that require numerical, graphical, or written solutions. The problems are based on the larger issues developed in the chapter. Smaller issues are addressed with approximately ten short-answer questions.

Critical Thinking:

This section provides a single multi-step problem that is an application of one of the major issues developed in the chapter.

Self-Test:

The self-test section provides fifteen true/false and twenty multiple-choice questions to validate areas of successful learning and to highlight areas needing improvement.

Solutions:

Detailed solutions for all problems and questions are provided at the end of each chapter.