Evaluating Monetary Policy

Remind yourself of the meaning of these key terms:

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Central Bank</td>
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<tr>
<td>Inflation Target</td>
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<tr>
<td>Symmetrical Target</td>
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<tr>
<td>Interest Rate</td>
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<tr>
<td>Exchange Rate</td>
<td></td>
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<tr>
<td>Money Supply</td>
<td></td>
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<tr>
<td>Transmission mechanism</td>
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<tr>
<td>Liquidity</td>
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<tr>
<td>Expansionary</td>
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<tr>
<td>Hot money</td>
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<tr>
<td>Deflationary</td>
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<tr>
<td>Bank Rate</td>
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Evaluating Monetary Policy Online Lesson: Accompanying Worksheet

Here are some analytical chains explaining how the monetary policy transmission mechanism works. Note down some ways in which these chains might be "broken".

1. **Interest rates rise** → **More expensive to borrow** → **Less incentive to borrow** → **Falling consumer spending** → **Falling AD** → **Falling inflationary pressure**

2. **Interest rates rise** → **More reward for saving** → **Greater incentive to save** → **Falling consumer spending** → **Falling AD** → **Falling inflationary pressure**

3. **Interest rates rise** → **Rates rise on variable rate mortgages** → **Less discretionary income** → **Falling consumer spending** → **Falling AD** → **Falling inflationary pressure**
Interest rates rise
- More expensive to borrow
  - Fewer business loans taken out
    - Falling investment spending
      - Falling AD
        - Falling inflationary pressure

Interest rates rise
- More reward for saving
  - Profits are saved not re-invested
    - Falling investment spending
      - Falling AD
        - Falling inflationary pressure

Interest rates rise
- Attracts inwards hot money flows
  - Demand for the currency rises on the Forex market
    - Value of currency rises i.e. appreciates
      - Exports become relatively more expensive

AD falls and inflationary pressure falls
- Value of net trade (X - M) falls
  - Demand for exports falls and demand for imports rises
    - Imports become relatively cheaper
Write an analytical paragraph explaining how, in theory, a fall in the interest rate should cause the general price level to increase.

Evaluate why, in practice, a fall in the interest rate may not cause the general price level to increase.
Unconventional Monetary Policy

Briefly outline why unconventional monetary policy measures have been needed in recent years:

Briefly explain what is meant by each of the following types of unconventional monetary policy:

<table>
<thead>
<tr>
<th>Type of monetary policy</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantitative Easing</td>
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<tr>
<td>Forward Guidance</td>
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<tr>
<td>Negative Interest Rates</td>
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<tr>
<td>Qualitative Easing</td>
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<tr>
<td>Credit Easing</td>
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</tbody>
</table>

Complete the following table:

<table>
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<tr>
<th>Type of monetary policy</th>
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</thead>
<tbody>
<tr>
<td>QE</td>
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</table>
“It Depends On”

Outline some “depends on” factors that influence the effectiveness of changes in the interest rate:

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On a separate piece of paper, have a go at writing a few “analytical chains” to explain a few of these “depends on” factors. There is an example in the video to help you.

Briefly outline other key evaluation points relating to monetary policy

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Explain why changes in the interest rate in a developing economy may have little effect: