Problem sets 2: Tools of monetary policy

EE432: Monetary theory and policy

Semester 1/2018

Instructor: Dr. Kittichai Saelee

Due on September 20th , 2018. in class.

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1) Using the supply and demand analysis of the market for reserves, indicate what happens to the federal funds rate, borrowed reserves, and nonborrowed reserves, holding everything else constant, under the following situations.

1.1) The economy is surprisingly strong, leading to an increase in the amount of checkable deposits.

1.2) Banks expect an unusually large increase in withdrawals from checking deposit accounts in the future.

1.3) The Fed raises the interest rate on reserves above the current equilibrium federal funds rate.

1.4) The Fed reduces reserve requirements.

1.5) The Fed reduces reserve requirements and then offsets this action by conducting an open market sale of securities.

2) Explain dynamic and defensive open market operations. What is the purpose of each type? Describe two situations when defensive open market operations are used. How are defensive open market operations typically conducted?

3) Attributed to the conventional policy tools, how does the change in FED fund rate affect the general market interest rates? Explain.

4) Discuss the intention and the expected outcomes of different QEs policy adopted by the Federal reserve between 2007 and 2014. How do the QEs affect general market interest rates? Why?