Study Questions No. 5 (March 4, 2012)
Economics 130
Winter 2012

These key terms and questions are designed to help you in your understanding of the material covered in class and in the textbook.

Key terms:

Inside lag
Outside lag
Monetary transmission mechanism
Deflation
Hyper-inflation
Liquidity trap
Seigniorage revenue
Velocity of money
Quantity theory of money
Real money balances;

Questions:

1. Why does a reduction in the Fed Funds rate generally lower short-term interest rates more than longer-term interest rates?
2. A rise in the Fed Funds rate tends to increase longer-term interest rates and cause a fall in asset prices. Explain how bank lending is impacted by both of these changes, i.e. explain these two parts of the monetary transmission mechanism.
3. Why hasn’t the sharp increase in bank reserves led to a rise in broader money growth? Explain in terms of the money multiplier.
4. Why are banks holding on to such large excess reserves? Why does the Fed believe that it can manage a smooth “exit” strategy if banks want to start lending more proactively? What are the risks of inflation?
5. QE means that the Fed is borrowing short term (creating bank reserves) and lending long term (buying long term treasury securities and MBS). Does this leave the bank open to capital gains and losses? What can it do to avoid the gains/losses?
6. The article published by the St. Louis Fed is more alarmist than the article published by the
7. Questions 3 and 8 on page 417.
8. Questions 1, 7, 11 on page 448.