Diploma Macro LT

class 2

Filip Rozsypal

February 16, 2012

Monetary policy framework: (from BoE website)

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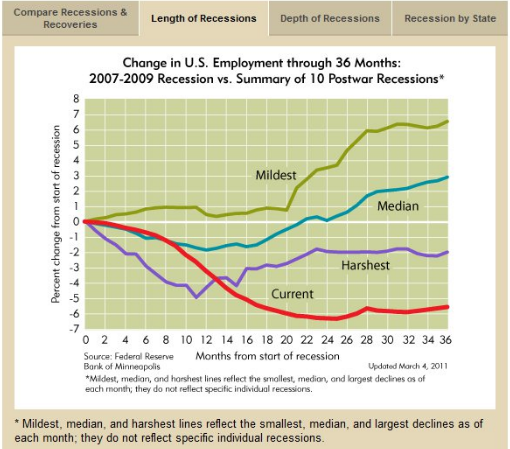
Quantitative easing

Current recession



from http://www.minneapolisfed.org/publications_papers/studies/recession_perspective/index.cfm

Reserves requirements

- Australia, Canada, New Zealand, Sweden
  - None
- UK
  - voluntary, but around 3% in practice after 1998
- Eurozone: 1%
- Switzerland 2.5 %
- US:

$<$\$11.5M	0%
(\$11.5M, \$71M)	3%
\$71M$<$	10%

Quantitative easing

Excess reserves

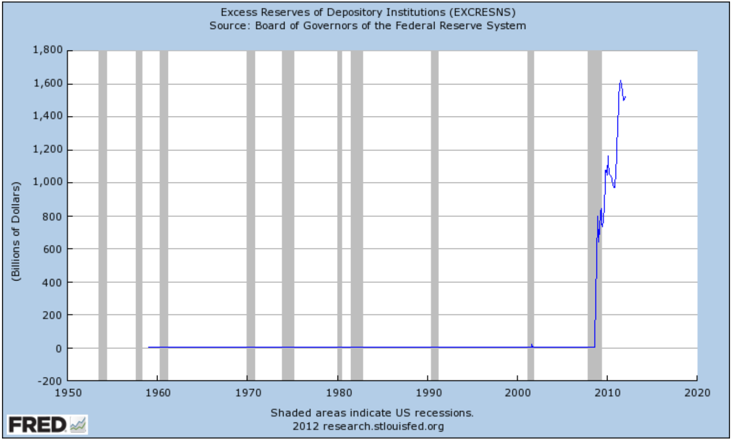
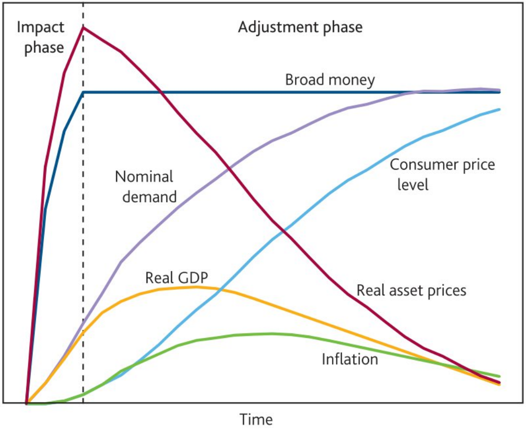


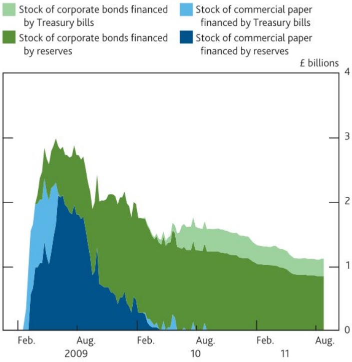
Figure: from FRED database

Quantitative easing

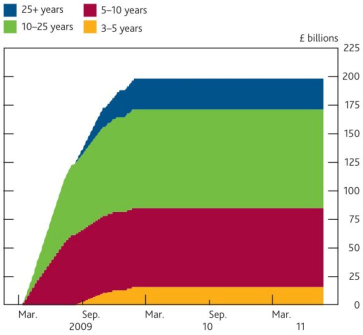
Aims of QE



www.bankofengland.co.uk/publications/quarterlybulletin/qb110301.pdf



(a) commercial paper



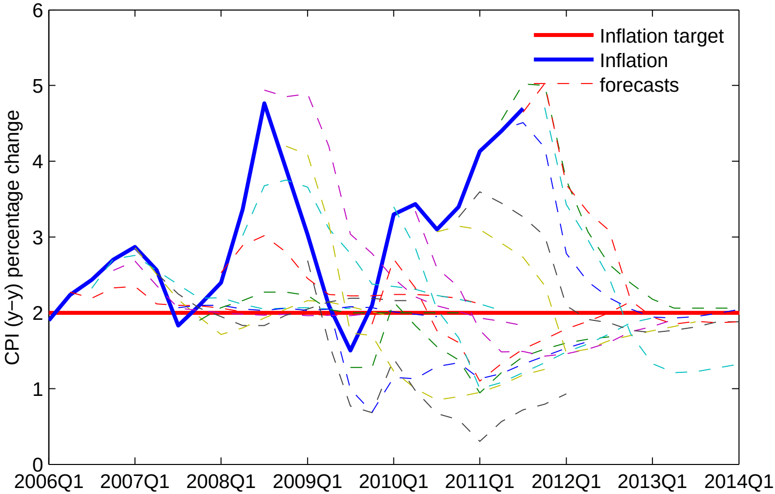
(b) gilts

Figure: Cumulative purchases of assets

www.bankofengland.co.uk/publications/quarterlybulletin/qb110301.pdf

Quantitative easing

Is it working?



Quantitative easing

Summary

- central bank is buying assets
  - overcome the zero bound on (short term) interest rates
  - fight fear of deflation
  - $r = i - \pi^e$... decrease real interest rates
- unprecedented scale
- recession longer then the previous ones
- inflation picking up in UK, but not as much in the US
  lots of uncertainty...

- data:
  - St Luis FED: Fred database
  - Minneapolis FED
  - Bank of Englad statistics
- QE evaluation:
  - Michael Joyce, Matthew Tong and Robert Woods: The United Kingdoms quantitative easing policy: design, operation and impact, BoE Macro Financial Analysis Division

interest yield vs yield to maturity

From Dr Geraats lecture 4:

- interest yield
  $i_c = \frac{C}{p}$, where C is the coupon, and P is the price of the bond
- yield to maturity/redemption yield
  interest rate that equates the price to the discounted stream of cash flow

Bond prices and expected inflation

$\pi^e \downarrow \Rightarrow B^d?$

You were right! Basic idea:

1. bonds are nominal assets, face value is a (nominal) sum of money earned when the bond matures
2. think about price level instead of inflation:
    - lower expected inflation means (relatively) lower future price level
    - if <u>the price level</u> is 50 instead of 100, you can by <u>twice</u> as much for the face value of the bond

Substitutions between <u>real</u> and <u>nominal</u> assets:

- <u>real assets</u> (holding capital, stock)
    - value of nominal assets decreasing in inflation $\Rightarrow B^d \uparrow$