The Role of Expectations in Monetary Policy
ECON 4673
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Problems

1. What does the Lucas critique say about the limitations of our current understanding of the way in which the economy works?

2. Can greater central bank independence make the time-inconsistency problem worse?

3. What are the arguments for and against monetary policy rules?

4. In some countries, the president chooses the head of the central bank. The same president can fire the head of the central bank and replace him or her with someone else at any time. Explain how that situation impacts the conduct of monetary policy. Do you think such a central bank will follow a monetary policy rule, or will it engage in discretionary policy?

5. How is constrained discretion different from discretion in monetary policy? How do the outcomes of these policies differ?

6. Suppose country A has a central bank with full credibility while country B has a central bank with no credibility. How does the credibility of each country's central bank affect the adjustment of the short-run aggregate supply curve to a monetary policy announcement? How does this result affect output stability? Use an aggregate demand and supply graph to support your answer.

7. How does a credible nominal anchor help improve the economic outcomes that result from a positive aggregate demand shock? How does a credible nominal anchor help if a negative short-run aggregate supply shock occurs? Use an aggregate demand and aggregate supply graph to support your answers.