Economics 103 — Spring 2018

International Monetary Relations

Writing Assignment 3
Unconventional Monetary Policy Tools

May 29, 2018

Due:	**Fri, June 8, *before* 5:00pm**
	Submit through TritonEd under *Turnitin*
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This writing assignment asks you to extend basic relationships from the course to accommodate two novel forms of monetary policy, widely implemented in response to the Great Recession. One tool is called Forward Guidance, the other tool Quantitative Easing. The assignment also asks you to critically assess the usefulness of these monetary policy tools.

Reading and Web Resources

Go to the website of the Brookings Institution and the unpublished working paper "Monetary Policy in a New Era" at `https://www.brookings.edu/wp-content/uploads/2017/10/bernanke_rethinking_macro_final.pdf`. Then go to the web page of the American Economic Association and the article "Dealing with Monetary Paralysis at the Zero Bound" at `https://www.aeaweb.org/articles?id=10.1257/jep.31.3.47`. **Read** the parts of the papers that concern Forward Guidance and Quantitative Easing—pages 1–15 in Bernanke (2017) and 47–54 in Rogoff (2017)—and observe how the two authors judge the effectiveness of the policies differently.

Select one of the two policy tools that you would like to write about.

If you choose to write about Forward Guidance, consider the material of lecture 12 on monetary policy under the liquidity trap in an open macro economy, and recast Forward Guidance as a way to alter the economy-wide perception of the expected nominal exchange rate. Analyze for yourself how Forward Guidance can succeed similar to a conventional monetary expansion.

If you choose to write about Quantitative Easing, consider the material of lectures 9 and 10 on the QQ curve and monetary policy in an open macro economy with a flexible exchange rate. In this context, recast Quantitative Easing as affecting a real money demand function $L(R, R_{QE}, Y)$ that depends on the interest rate for money-market deposits $R = 0$, another interest rate R_{QE} for domestic assets with longer maturities, and national income Y through the interest rate R_{QE}, and consider a variation of the Uncovered Interest Parity condition by which the interest rate R_{QE} for domestic assets equals the interest rate R^*_{QE} for comparable foreign assets and the expected nominal exchange rate depreciation. Analyze for yourself how Quantitative Easing can succeed similar to a conventional monetary expansion.

Writing

Suppose you are writing to explain one of the two novel monetary policy tools—Forward Guidance or Quantitative Easing—to a freshman at UC San Diego. 1) **Write** an opening paragraph that explains what the policy is, what aspects it shares with conventional policy tools, and what is new. 2) **Use** the analytic apparatus of the relevant model, *but no graphs*, to **describe** in intuitive words how the monetary policy tool can succeed in stimulating output in an open macro economy. Make sure to explain your reasoning. If you need more than one paragraph to do so, write more than one paragraph. 3) In a final paragraph critically **assess** the practical usefulness and limitations of the monetary policy tool.

References

Bernanke, Ben S. 2017. "Monetary Policy in a New Era." Brookings Institution, unpublished manuscript.

Rogoff, Kenneth. 2017. "Dealing with Monetary Paralysis at the Zero Bound." *Journal of Economic Perspectives*, 31(3): 47–66.