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**UNIVERSITY OF LONDON** **279 0014 ZA**

**BSc degrees and Diplomas for Graduates in Economics, Management, Finance and the Social Sciences, the Diploma in Economics and Access Route for Students in the External Programme**

**Monetary Economics**

Wednesday, 17 May 2006 : 10.00am to 1.00pm

Candidates should answer **FOUR** of the following **TWELVE** questions. All questions carry equal marks.

PLEASE TURN OVER


UL06/17

1. It is often suggested that positive monetary policy shocks have smaller real effects than negative monetary policy shocks. Why might monetary policy have these asymmetric effects and what problems does this asymmetry pose for policy makers?

2. Why might policy makers pursue counter-cyclical monetary policy? What are the problems with adopting a counter-cyclical monetary policy?

3. Cross border capital controls are sometimes imposed in response to a financial crisis. To what extent do they produce a solution to the crisis and what other problems do they create?

4. Why does a normal yield curve show a positive relationship between yield to maturity and time to maturity, and how do changes in monetary policy impact on the yield curve?

5. Policy makers face uncertainty from several sources when setting monetary policy, including data uncertainty, parameter uncertainty and model uncertainty. Explain why uncertainty arises for each of these reasons and what policy makers can do to deal with the problem in each case.

6. Why have some emerging economies replaced their national currency with the US dollar (a policy known as dollarisation)? What are the disadvantages with this policy?

7. It has been suggested that the Bank of Japan should have credibly targeted a positive inflation rate, in order to hasten Japan's recovery from its recent long period of economic stagnation. (Inflation has been around zero in recent years, and in some years prices have actually fallen, despite interest rates also around zero percent per annum.) How might such a policy have worked to revive the economy? What are the difficulties of employing such a policy?

8. What is meant by 'hyperinflation', and under what circumstances might an economy suffer a period of hyperinflation? Explain what role, if any, might be played by fiscal policy (public spending and taxation), both in causing and in curing an episode of hyperinflation. Illustrate your answer with reference to one or two historical examples of hyperinflation.

9. Explain how banks create money by granting loans to their customers. What factors limit the quantity of loans that banks make, and thus influence the quantity of money in the economy? Is the rate of interest determined by equilibrium in the market for bank loans, or in the market for money balances?

10. Explain the key assumptions and predictions of the Baumol-Tobin model of the transactions demand for money. Show how the predictions that the income elasticity of the demand for money equals one half, and the interest elasticity equals minus one half, are obtained. Assess the empirical validity of this theory.

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11. It is reported that in the United States, Ben Bernanke, who has succeeded Alan Greenspan as the Chairman of the Board of Governors of the Federal Reserve System, is likely to shift policy towards explicit inflation targeting. What might be the advantages and disadvantages of such a policy, as compared with the policies pursued under Greenspan?

12. To what extent is it possible for a Central Bank that is attempting to achieve an inflation target to maintain the stability of the country's financial system at the same time?

END OF PAPER