EC1B5 | Chapter 13

Macroeconomic Policy

Additional Practice Questions:

Book Question 2

The following figures show the European Central Bank's (ECB) balance sheet as well as the balance sheet of a commercial bank in France, Crédit Paribas Bank. Suppose the ECB wants to raise bank reserves by €2 billion. Assuming that Crédit Paribas Bank is the only bank that is going to undertake these transactions with the ECB, show how ECB's as well as Crédit Paribas Bank's balance sheet will change.

The European Central Bank			
Assets		**Liabilities and Shareholders' Equity**	
Treasury Bonds	€3,000 billion	Reserves	€1,700 billion
Other bonds	€1,000 billion	Currency	€1,300 billion
Total assets	**€3,000 billion**	**Total liabilities**	**€3,000 billion**

Crédit Paribas Bank			
Assets		**Liabilities and Shareholders' equity**	
Reserves	€300 billion	Deposits and other liabilities	€1,100 billion
Bonds and other investments	€1,000 billion	**Shareholders' equity**	**€200 billion**
Total assets	**€1,300 billion**	**Liabilities + shareholders' equity**	**€1,300 billion**

Book Question 3

Indicate whether the following phenomena will lead to a shift in the reserves supply and demand curve for the Bank of England (BoE), where the horizontal axis indicates the quantity of reserves and the vertical axis the interest rate of the Bank of England. In your answer, use a graph of the money market to show how the Bank of England's action translates into a higher interest rate.

a. Economic contraction.
b. Increasing deposit base.
c. Selling governmental bonds.
d. If the demand curve shifts to the left, how should the BoE respond to keep the interest rate constant?

Book Question 8

Two economists estimate the government taxation multiplier and come up with different results. One estimates the multiplier at 0.75, while the other comes up with an estimate of 1.25.

a. What do these different estimates imply about the consequences of government taxation (or transfers)?

b. If the current value of GDP is $20 trillion and the government is planning to make transfers to people of $1 trillion, what is the percentage increase in GDP for each of the two estimates for the multiplier? Assume the increase in spending occurs all in 1 year.

Book Question 11

The European Central Bank (ECB) manages monetary policy for the eurozone. In 2019, the ECB's policy rate (the ECB's version of the federal funds rate) was already at 0 percent, before the start of the 2020 recession.

a. Using the concept of the zero lower bound, explain how low interest rates (before a recession starts) could constrain countercyclical monetary policy.

b. Though fiscal policies are controlled by individual governments in the eurozone, the European Union's Stability and Growth Pact places strict limits on country-level deficit spending. Explain how the confluence of the zero lower bound and restrictions on the fiscal deficit might be problematic for countercyclical macroeconomic policy.