

231025 – The MP Curve and Central Banks

<p>The Monetary Policy (MP) curve is a horizontal line plotted alongside the IS curve.</p> <p>The interest rate set by central banks determines where the MP line exists.</p>
<p>How do Central Banks choose monetary policy?</p> <p>Different central banks have different goals.</p> <ul style="list-style-type: none"> • US Central Bank (The Federal Reserve (“The Fed”)) cares about _____ and _____. ◦ This is called the _____. • European Central Bank (ECB) and Bank of Japan (BoJ) only care about _____. • People’s Bank of China (PCB/PBOC/中国人民银行) cares about _____ currency value • What might be a Central Bank’s goals if it doesn’t have independence?
<p>What do central banks do?</p> <ul style="list-style-type: none"> • Control domestic interest rates • Ensure well-functioning banking and finance sectors
<p>What does the Fed’s MP choice look like?</p> <ul style="list-style-type: none"> • FOMC: • Fed Funds Rate: • Basis Points:

231025 – The Market for Reserves

<p>The Fed controls interest rates through bank reserves</p>
<p>Why do banks need reserves?</p>
<p>Banks make money from _____. Banks use _____ to stay operational.</p>
<p>Banks with not enough reserves to meet regulations can borrow overnight on the Federal Funds Market.</p>
<p>Who lends in the overnight market?</p> <ul style="list-style-type: none"> • Banks • “Shadow Banks” • The Fed ◦ “Lender of Last Resort”
<p>Fed controls 3 rates:</p> <ol style="list-style-type: none"> 1. Discount Window 2. IO(E)R: 3. ON RRP:
<p>The Fed Funds rate usually falls between _____ and _____. Why?</p>
<p>Why don’t banks want to borrow from the Fed directly?</p>

Two systems: Ample v Scarce Reserves	
Scarce Reserves	Ample Reserves
Used in the US before the Financial Crisis Still used in countries around the world Interest depends on _____ Small increases in money _____ interest rates	Current approach to monetary policy Most frequently used in US / EU Interest depends on _____ Small increases in money _____ interest rates
Open Market Operations determine money supply	
• To increase the money supply, the Fed _____ Treasuries (or other government debt)	
Conventional monetary policy tools <ul style="list-style-type: none">• Reserve Requirements:• Open Market Operations	Newer monetary policy tools <ul style="list-style-type: none">• Overnight Rates• QE<ul style="list-style-type: none">○ MBS○ Long term Treasuries○ Corporate Debt• Forward Guidance

Figure 5
Monetary Policy with Ample Reserves

