231025 – The MP Curve and Central Banks

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| The Monetary Policy (MP) curve is a horizontal line plotted alongside the IS curve.  The interest rate set by central banks determines where the MP line exists. |
| **How do Central Banks choose monetary policy?** |
| Different central banks have different goals.   * 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? |
| What do central banks do?   * Control domestic interest rates * Ensure well-functioning banking and finance sectors |
| What does the Fed’s MP choice look like?   * FOMC: * Fed Funds Rate: * Basis Points: |

231025 – The Market for Reserves

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| **The Fed controls interest rates through bank reserves** |
| Why do banks need reserves?  Banks make money from \_\_\_\_\_\_\_\_\_\_\_\_\_. Banks use \_\_\_\_\_\_\_\_\_\_\_\_\_\_ to stay operational. |
| Banks with not enough reserves to meet regulations can borrow overnight on the Federal Funds Market. |
| Who lends in the overnight market?   * Banks * “Shadow Banks” * The Fed   + “Lender of Last Resort” |
| Fed controls 3 rates:   1. Discount Window 2. IO(E)R: 3. ON RRP: |
| The Fed Funds rate usually falls between \_\_\_\_\_\_\_\_\_ and \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Why? |
| Why don’t banks want to borrow from the Fed directly? |

231025 – Ample v Scarce Reserves

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| **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   * Reserve Requirements: * Open Market Operations | Newer monetary policy tools   * Overnight Rates * QE   + MBS   + Long term Treasuries   + Corporate Debt * Forward Guidance |

231025 – The Market for Reserves

