

Assignment 2

September 2022

Rules of the game

Submit a machine-typed solution in pdf. Use Canvas to submit your group's solution.; make sure to submit your memo via the assignment (not your group's sub-site, only one member must submit). The grade of this assignment is 20% of the final grade. The submission deadline is **Sunday, October 16, midnight**.

Inflation and inflation expectations

Inflation is currently running at 9.1% in Europe¹ and 9.9% in the United Kingdom² (August, year-on-year). Central banks, governments, companies, and individuals worry about this sudden, unexpected high inflation.

Suppose that you work for a newly elected member of parliament of either i) the Netherlands, ii) Italy or iii) the United Kingdom (choose one!). She is a junior member of the parliament's fiscal committee and she just met with representatives of the central bank (depending on your country, either the ECB or the BoE). You explained to the representatives of the central bank that you want to compensate households for the high inflation that lowers their purchasing power. The representatives of the central bank expressed their concerns since this might offset their actions to curb inflation.

Write her a non-technical memo using at **most 4 pages** (including text, footnotes, tables, figures, references, everything!). Use 1.5 line spacing, font size 11, and set margins to 1.0 inch. Your memo must include the following:

- What happened to inflation and inflation expectations since 2008? Provide a decomposition of inflation in the last year. (20 points)
- What are the pros and cons of the current high inflation? Which sectors benefit? (20 points)
- How did central banks respond to the sudden rise in inflation? Provide an overview of their actions and communications. Also explain why their communication matters. Pay special attention to inflation expectations and explain why that matters. (20 points)
- Should the fiscal policymakers and monetary policymakers coordinate their actions? (20 points)

Your memo must be readable and to-the-point, addressed to your member of parliament, with a short introduction and a body. A conclusion is not necessary for a memo of this length (20 points for structure, readability and use of figures and tables). You may use any source available (mention your **references in footnotes**).

¹ https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html, retrieved 28 September 2022

² <https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/august2022>, retrieved 28 September 2022