Tutorial 3.

(Q1) Inflation measures the overall increase in the price level of goods and services in the economy over time.
Includes all items, such as food and energy prices which can be very volitile.
Core Inflation: Excludes food and energy prices to provide a more stable measure of long term inflation trends.

(Q2) The rise in headline Inflation could be due to temporary factors such as oil price spikes, supply chain disruptions or adverse weather.
If long term inflation expectations remain stable, the market believes the CB will keep inflation under control, reducing the risk of a self-reinforcing wage-price spiral.
The CB must assess if the inflation overshoot is persistent or transitory before adjusting policy.
CB can hold intrest rates constant, if price shock is deemed temporary, moniter future data to avoid tightening.
Targetted communication - reasure markets that CB remains committed to price stability while acknoledging the temporary deviations from the target are expected.

(Q3) The repo rate = intrest rate at which CB lends money to the commercial banks for short term liquidity needs. They typically use gov securities as collaterol
Higher repo rate → ↑ borrowing costs for banks → reduce MS → helps control inflation.
Lower repo rate → ↓ borrowing costs for banks → ↑MS → stimulate economic activity.

PAPERWORK

(b) Interbank rate → intrest rate at which banks lend to eachother in the short term money-market, usually for overnight or very short durations.

→ it reflects liquidity conditions in the banking system.

→ it influences the repo rate, but also by market forces like demand and supply for funds among banks.

(Q4) CB liquidity management means banks can borrow directly from the CB at the repo-rate if they face liquidity shortages. This acts as a ceiling on interbank lending rates since no bank would borrow at a significantly higher rate in the interbank market when they can access CB liquidity at the repo-rate.

Market Competition amongst banks → Banks with surplus reserves lend to those in need at rates competitive with the repo rate.

(b) If there is a shortage of reserves in the banking system banks may bid up the interbank rate above the repo-rate.

If banks hold excess reserves, the interbank rate may fall below the repo rate as banks compete to lend funds.

- The repo rate is a risk free borrowing rate from the Central bank, but the interbank rate reflects credit risk between banks.

During financial crises, banks may be unwilling to lend to eachother → higher interbank rate relative to repo rate.

⊖ Stricter capital requirments may reduce interbank lending pushing the interbank rate above the repo rate.

⊖ If the market expects the CB to ↑ the repo rate, the interbank rate may ↑ in anticipation.

If market expects a rate cut, the interbank rate may drop below the repo-rate.

fred.stlouisfed.org

Migration and Economic Growth | Home - Netflix | Home | MyEd Student and Staff... | File | Inflation vs Core Inflation | Overnight Reverse Repurchase...

Overnight Reverse Repurchase Agreements Award Rate: Treasury Securities Sold by the Federal Reserve in the Temporary Open Market Operations (RRPONTSYAWARD)

DOWNLOAD

Observation:
2025-01-31: **4.25**
(+ more)
Updated: Jan 31, 2025 1:01 PM CST

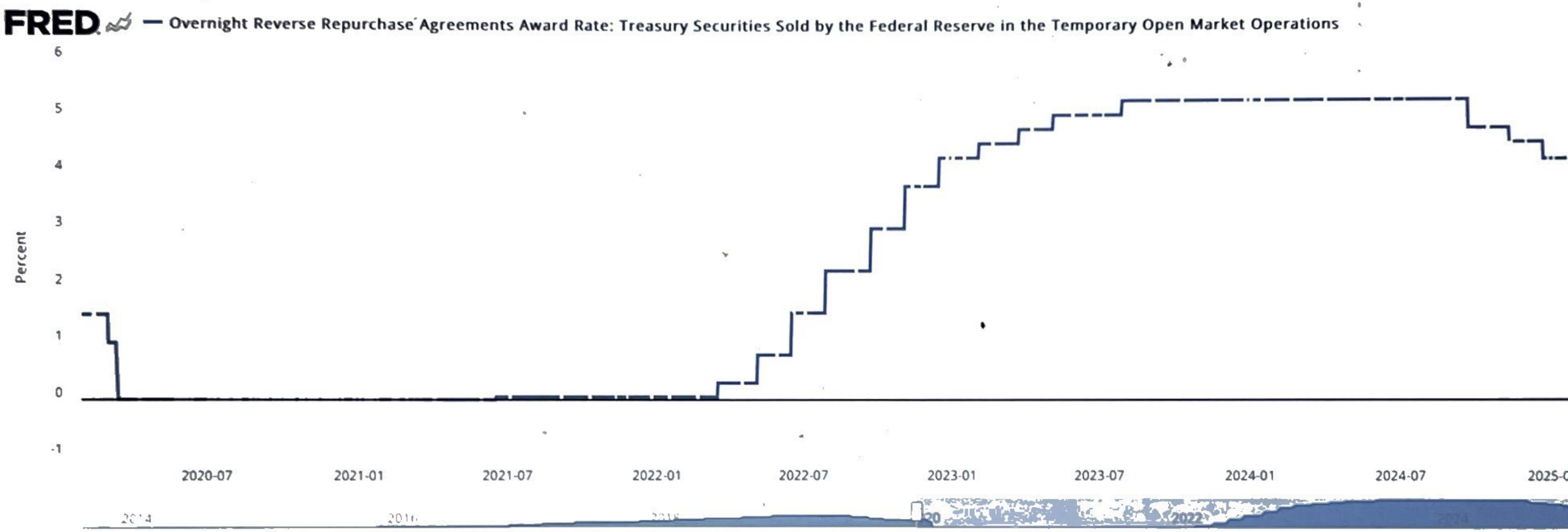
Units:
Percent,
Not Seasonally Adjusted

Frequency:
Daily

1Y | 5Y | 10Y | Max

2020-01-31 to 2025-01-31

EDIT GRAPH



Shaded areas indicate U.S. recessions.

Source: Federal Reserve Bank of New York

fred.stlouisfed.org

Share Links | Account Tools

NOTES

Source: Federal Reserve Bank of New York **Release:** Temporary Open Market Operations

Units: Not Se