Universität Bern | SS 1999
Monetary Theory an Policy II | Prof. Dr. Harris Dellas

Review Questions: Section 3

1. If monetary policy is completely endogenous then it is impossible to identify it. Comment.

2. Do deficits have to be inflationary? Are they in practice?

3. High nominal interest rates signify tight monetary policy. Comment.

4. Derive the optimal enforceable rule in Barro and Gordon assuming that once credibility is lost it can never be restored; derive the optimal, time consistent rate of inflation.

5. If everything is indexed to the price level then the discretionary rate of inflation is time consistent. Comment.

6. Barro and Gordon employ an expectations mechanism that involves essentially a one period punishment "strategy". That is,

   E(p(t)) = p* if p(t-1) = E(p(t-1))
   E(p(t)) = b/a if p(t-1) ≠ E(p(t-1))

   Consider now an "infinite punishment " strategy that says that if there is a deviation from p* then people will always expect p = b/a in the future independent of the future actions of the policymaker. Which of these two strategies will be associated with a lower time consistent rate of inflation? Will any of them succeed in eliminating the inflationary bias in the conduct of monetary policy?

7. How does the slope of the short run Phillips curve affect the level of the optimal time consistent rate of inflation (given the preferences of the policymakers)?

8. A government with a good anti-inflation reputation is in a better position to carry out short term discretionary policies than a government with a bad reputation. Evaluate. What do we mean by "better position"?

9. What is the main criticism of the VAR approaches to the identification of monetary policy?

10. What do you consider to be the most overwhelming piece of evidence in favor of the view that monetary policy matters significantly for macroeconomic activity?