Institute for Economic Studies, Faculty of Social Sciences, Charles University

JEM027 ADVANCED MONETARY ECONOMICS

State examination questions

1) Role of money in the economy

What are the basic roles of money in the economy? What explains the existence of money? What role does money play in the Walrasian economy and what role in the real world? How have the techniques of carrying out trade and transactions developed in the human history? What are the desirable properties of money according to the classical literature? What properties are emphasised by the modern literature? Choose either the model of overlapping generations or the random matching model (see Kiyotaki and Wright, 1992) and describe, how the model explains the role of money in the economy. What are the model's policy implications?

2) Demand for money on the microeconomic level

Which motives to hold money do you know? Explain the Baumol-Tobin model of money demand and compare it with some other model (e.g. the Miller-Orr model or the quantity theory of money). Which variables affect the demand for money according to these models and with what elasticity? How does uncertainty affect the money demand in the various models? What is the role of the transaction costs?

3) Demand for money on the macroeconomic level

Which monetary policy regime relies on a stable and/or predictable money demand function? Do some countries apply this monetary policy regime? Why is stable money demand important for this regime? Relate this to the main conclusions of W. Poole (1970), who studied under what circumstances it is better to use money supply rather than short term nominal interest rates as a monetary policy instrument. What is the international experience with the stability and/or predictability of the demand for money? What role do monetary aggregates play in the ECB'S monetary policy and what is the experience so far?

4) Supply of money and monetary policy implementation in normal times

How is the money supply in the economy determined according to the monetarist theory and according to the post-Keynesian economics? What determines whether money is exogenous or endogenous? Which instruments of implementing monetary policy are used by modern central banks in normal times (e.g. Fed, ECB, BoE, CNB)? What are the reasons for using these instruments? Is money for these central banks an instrument of monetary policy (exogenous variable) or an endogenous variable? What modifications of the IS-LM model were proposed by D. Romer in his article „Keynesian Macroeconomics Without the LM Curve“?

5) Monetary policy during the recent crisis

What phases of the recent (i.e. 2007-2013) crisis can you distinguish? Do you know some unconventional monetary policy instruments which have been applied during the crisis? Have they differed in various phases of the crisis? Have they differed among the major central banks (e.g. the ECB, Fed, BoE and the Swiss National Bank)? If yes, why? Why were these instruments needed? What policy instruments are available at the zero lower bound of the nominal interest rates and how do they work? Have these tools been effective in stimulating the economy and avoiding the deflation risk?

6) Central bank reactions functions (monetary policy rules)

What is the Taylor rule? What properties must a good central bank reaction functions have (the "Taylor principle")? Why is it so important? What alternative central bank reaction functions do you know? What are the advantages and disadvantages of optimal reaction functions (monetary policy rules)?

7) Monetary transmission

Why does monetary policy affect inflation with time lags? Which channels of monetary transmission do you know? What role is played in the transmission by the banking sector? What is the role of expectations? In which situations may arise some problems in the monetary policy transmission? How does the transmission and the strength of its individual channels differ among different economies?

8) Seigniorage and the inflation control

What is seigniorage (monetary income)? Do you know more alternative definitions? Explain the Cagan model of seigniorage and the way in which a hyperinflation may be generated in this model. Explain the term "fiscal dominance" based on the paper by Sargent and Wallace (1981). What is the "prohibition of monetary financing" in the EU and why is it important? Do you know any central banks with negative equity? Does it have any implications for their monetary policy conduct?

9) Central bank independence, transparency and accountability

Explain how an inflationary bias may emerge according to the model of dynamic inconsistency in monetary policy. How does this model correspond with the actual historical experience from the 1970s? What solutions to this problem have been proposed in the theoretical literature? What are their potential advantages and disadvantages? How does modern central banking develop in terms of central bank independence and transparency? Why is independence and transparency so important? What is the empirical experience with central bank independence and actual performance of the monetary policy?

10) Monetary policy regimes in practice

Compare the Czech National Bank (CNB), European Central Bank (ECB), Bank of England (BoE) and Fed in terms of their: legal mandate, monetary policy regime, main monetary policy instrument(s), independence, transparency and key communication channels. Why do you thing have the ECB and Fed not adopted an inflation targeting regime? Do you thing they should do it in the future?

11) Inflation targeting

What are the main features of the inflation targeting regime? How does inflation targeting differ from the alternative monetary policy regimes? What are its advantages and potential disadvantages? Name a few countries that apply inflation targeting. Why may inflation in this regime deviate from central bank's targets? What policy horizon should an inflation targeting central bank use to achieve its targets? Which central bank reaction function describes an inflation targeting central bank reasonably well? What is the international empirical experience with using inflation targeting? What is the difference between inflation targeting and price level targeting.

12) Monetary policy under uncertainty

Which types of uncertainty must be faced by the monetary policy-makers? Under what circumstances can a central bank behave according to the certainty equivalence principle? Explain the "Brainard principle". Is this principle universally valid? How do central banks cope with uncertainty in practice? What role is played by uncertainty in central bank communication?

13) Monetary policy, asset prices and financial stability

What is the role of asset prices in the monetary policy transmission mechanism? Is it enough to target CPI inflation, or should central banks target asset prices as well? What are pros and cons of targeting the asset prices? How has the 2007-2010 crisis affected this debate? Which improvements in monetary policy would you see as crucial in reflection of the crisis? Is one tool enough to target both the CPI and financial stability? What additional policy tools could be used?

14) **Modelling macro-financial linkages, implications for monetary policy** (only for students that took the course in 2011 or later)

What are the key sources of financial imperfections? Explain the main idea of Akerlof's (1970) paper about the "market for lemons". What is the role of the credit channel in monetary policy transmission? Explain the term "credit rationing". How are financial imperfections being incorporated into dynamic macroeconomic models (e.g. the DSGE models)? According to these model, how can a financial shock propagate through the economy? What do the financial friction imply for the strength of monetary policy transmission?