

January Examination Period 2023

ECN355 Macroeconomic Policy

Duration: 2 hours

YOU ARE NOT PERMITTED TO READ THE CONTENTS OF THIS QUESTION PAPER UNTIL INSTRUCTED TO DO SO BY AN INVIGILATOR

Answer TWO questions, one from each of sections A and B.

If you answer more questions than specified, only the first answers (up to the specified number) will be marked.

Cross out any answers that you do not wish to be marked.

You are permitted to bring 20 x A4 pages of notes into your examination (i.e. 10 double sided pieces of paper). These can be typed or handwritten and can include graphs and images. They can include material from any source.

Calculators are permitted in this examination. Please state on your answer book the name and type of machine used. Complete all rough workings in the answer book and cross through any work that is not to be assessed.

Possession of unauthorised material at any time when under examination conditions is an assessment offence and can lead to expulsion from QMUL. Check now to ensure you do not have any notes, mobile phones, smartwatches or unauthorised electronic devices on your person. If you do, raise your hand and give them to an invigilator immediately.

It is also an offence to have any writing of any kind on your person, including on your body. If you are found to have hidden unauthorised material elsewhere, including toilets and cloakrooms it will be treated as being found in your possession. Unauthorised material found on your mobile phone or other electronic device will be considered the same as being in possession of paper notes. A mobile phone that causes a disruption in the exam is also an assessment offence.

EXAM PAPERS MUST NOT BE REMOVED FROM THE EXAM ROOM

Examiner: Prof F. X. Mateos-Planas

© Queen Mary, University of London, 2023

Remark:

- In your answers, when pertinent, specify the theoretical models that you use.

Section A (answer ONE question)**Question 1**

Describe the HP filter and explain what it does. How does it compare with linear de-trending? Discuss if it makes sense to use the HP filter to approximate the natural level of output. Based on existing studies, describe some historical episode where such type of approximation may have resulted in questionable policy choices. Explain if this type of situation is relevant in 2022.

[50 marks]

Question 2

Assume an economy far from the zero lower bound. Explain how an interest rate shock can be modelled. Derive the impact effect of this shock on output, inflation, employment and wages, and identify the factors that determine the size of this effect. Trace the dynamics of the subsequent adjustment, and explain how you would simulate it. Does the model predict paths consistent with the impulse-response functions (IRF) obtained in existing studies for the U.S.?

[50 marks]

Question 3

The UK, along with many other economies, is experiencing rising energy prices. What should the Bank do in order to respond in an optimal way? Compare with the policy response if the Bank were to adjust the interest rate to deviations of inflation from target according to an ad-hoc fixed rule. If there is some 'divine coincidence', why do you think policymakers look so troubled today?

[50 marks]

Question 4

Explain the determinants of the multiplier of government spending when outside of a liquidity trap. What is specifically the role of financial constraints, nominal rigidities, and the stance of the central bank? How could your answer depend on whether government spending has a positive effect on productivity?

[50 marks]

Section B (answer ONE question)

Question 5

Explain how an economy could fall into a liquidity trap. Specifically highlight the role of monetary policy in that explanation. Relate your explanation to some recent real-world situation. Do you think that the liquidity trap remains relevant in 2022?

[50 marks]

Question 6

Describe the channels and mechanisms of the effects of forward guidance in a liquidity trap. How can you describe represent graphically those theoretical effects? Can you find specific real-world examples of implementation of forward guidance? Discuss and assess their effectiveness.

[50 marks]

End of Paper