Economics 103, Federal Reserve Module

Winter 2020

Bates College

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To complete this assignment, you should:

1. Watch the recorded lecture on the Federal Reserve. This will provide you with much of the necessary background.

2. Listen to Fed Chairman Jerome Powell's conference call from Sunday, March 15 when he announced an unscheduled 1% drop in the Federal Funds Rate.

3. Read this article from CNN on why the Fed's rate cut may not do much.

4. Read this pessimistic take on the macroeconomic outlook from *The Atlantic*.

The lecture for #1 is available on the course's Lyceum page.

Instructions: Answer all parts of all questions. You are expected to independently craft your answers. Answers which incorporate current macroeconomic data are especially encouraged.

1. What interest rate did the Federal Open Market Committee lower to 0-0.25%? Do many economic decisions directly depend on this interest rate?

2. Which components of GDP are most likely to increase in response to the FOMC's decision to lower interest rates?

3. True or False? Lower interest rates will provide major boost to both aggregate demand and aggregate supply. Explain how each is affected by monetary policy?

4. How concerned should the Fed be about causing inflation to rise well above 2% because of such low interest rates?

5. The most recent data on GDP show that growth was around 2% in 4Q2019 (and at or above potential output), and that core inflation was around 1.6%. Given these conditions, are interest rates lower than suggested by rules like that of Taylor (1993)?

6. Looking at data since the Fed's action, have long-term interest rates (*e.g* mortgage rates, long-term Treasuries, corporate interest rates) changed since the Fed's actions?

7. How is Quantitative Easing different from simply lowering interest rates?

8. How might the Fed's new round of Quantitative Easing help increase employment (or alternatively, prevent an even bigger increase in unemployment)?

9. True or False? Unemployment claims rose after the Fed's actions. The Fed's actions were thus a mistake which made the macroeconomic situation worse.

10. Provide a 1-2 paragraph summary of why the Fed's actions were or were not the right policy decision.