Monetrary Policy: Problems

1. True or False. The Federal Open Market Committee meets every six weeks and sets a target for the $M2$ money supply.

2. Suppose that a bond pays $1000 in one year. If the bond sells for $950, what is the bond yield?

3. Suppose that a bond pays $1000 in three years. If the bond sells for $950, what is the bond yield?.

4. Why do open market purchases of bonds lower interest rates and increase the money supply?

5. Suppose that short term (one year) interest rates equal 7%. Now suppose that starting in one year, expected future interest rates initially equal 5% forever. Calculate the two and three year interest rates.

6. True or False? Raising short term rates today (from #5) will have no effect on either the two or three year rate.

7. From #5, how could forward guidance be used to raise long term interest rates?

8. True or False? Almost all of the Fed's balance sheet currently consists of Treasury Bonds.

9. As of March 2015, why is the Fed expected to raise interest rates in the next several months?

10. What is a liquidity trap and what problems does it pose for monetary policy during a recession?