

Econ 216, Fall 2021

HW #5

This assignment asks students to examine the Volker disinflation of the early 1980s, and connect it to today's challenges facing the Fed. It is due on 11/18.

The following two articles (especially the second one) are the main basis for this assignment:

Maria Demertzis, M., and N. Viegi 6/28/16. "[Credibility of central bank\(er\)s](#)" *VoxEU*.

Goodfriend, M, and B.F. King. 2005. "[The Incredible Volcker Disinflation](#)" *Journal of Monetary Economics*, Vol. 52: 981–1015.

The Goodfriend and King article contains a theoretical model in Section 2. This is not essential for answering the questions on this assignment.

1. How does the Fed's current credibility compare to that in the 1970s and early 1980s.
2. How do the "double dip" recessions of 1980 and 1981-82 compare to the Great Recession and covid-19 recession in length and severity?
3. Goodfriend and King (2005) state that "the real effects of the Volcker disinflation were mainly due to its imperfect credibility." What does this mean?
4. Suppose that the current Fed decides that it must act to reduce inflation. Would its current level of credibility make this task easier or harder than in 1980-82?
5. Would a flatter Phillips Curve make the Fed's task of lowering inflation easier or harder?
6. What evidence do Goodfriend and King (2005) provide that the Fed lacked credibility in the early 1980s?
7. What were the redistributionary effects of the large decline in inflation in the early 1980s? You might want to consider how this impacted real interest rates (interest rates less inflation).

8. The Volcker Fed temporarily targeted monetary aggregates (textite.g M2) instead of the Federal Funds Rate. Explain what this means.

9. Why did the Federal Funds rate reach 19% in July 1981?

10. Why are some observers worried that a pending Fed policy error could lead to a recession?

Bonus. Attend an Economics seminar. Send me a few paragraphs on what you learned and whether you think the speaker would be a good addition to the Bates Economics faculty. You may also receive this bonus for last week's speaker as well (maximum 2 per semester).