CLASS 4

TOPIC	***Monetary Policy***
LEARNING CONTENT - DETAILED CHARACTERISTICS	We define monetary policy, its objectives (price stability, output stability, exchange rate stability, and financial stability) and instruments and differentiate them from fiscal policy and macroprudential policy. Economic and institutional arguments are discussed. Monetary policy consists primarily of setting the price and quantity of central bank liquidity. We define interbank market, money market, the process of money creation, monetary aggregates, and money multipliers. Conventional and unconventional monetary policies and instruments are considered as well as monetary policy specificities under normal times and at zero lower bound. The conventional monetary policy instruments are refinancing operations, open markets operations, and minimum reserve requirements while unconventional monetary policy instruments are purchases of securitized loans, quantitative easing, forward guidance. The central banking structure, functioning, and credibility are commented on. A brief history of central banking is presented so to consider that the balance between price stability and financial stability has always been a major concern. A special emphasis is put on monetary policy rules and their effect on the monetary policy strategy that a central bank follows. Three types of monetary policy rules are distinguished – instrument rules (i.e. the Taylor rule), targeting rules (i.e. inflation targeting), and intermediate-targeting rules (i.e. money targeting).
KEY WORDS	Monetary policy, central bank, interbank market, money market, money creation, monetary aggregates, money multiplier, refinancing operations, open markets operations, minimum reserve requirements, purchases of securitized loans, quantitative easing, forward guidance, monetary rules, monetary policy strategy, the Taylor rule, inflation targeting, money targeting.
SUGGESTED TOOLS	Power-point presentation Economic data transformation Real-world personal observation Interactive and group discussions A personal study plan
TIPS / METHODOLOGICA L REMARKS	Learning-by-doing and case studies activities. The focus is on the conventional and unconventional monetary policies and instruments and the central bank role.

(if applicable)		
IMPLEMENTATION OF THE CLASSES	STEP 1	We consider that monetary policy is a demand-side policy which is generally delegated to a central bank with an explicit and narrow mandate (generally price stability) and its effects on aggregate demand is only indirect. We reflect the 2008 financial crises effect on monetary policy framework and differentiate conventional and unconventional monetary policies and instruments.
	STEP 2	The key economic terms and concepts are defined and discussed – interbank market, money market, money creation, monetary aggregates, money multiplier, refinancing operations, open markets operations, minimum reserve requirements, purchases of securitized loans, quantitative easing, forward guidance. The specificities of monetary policy in normal times and at zero lower bound are commented on. See work card 1.
	STEP 3	We consider conventional and unconventional monetary policies. The lecturer makes students aware that different central bank strategies can be combined: the central bank may ease the access of commercial banks to central bank liquidity; the central bank can intervene in a targeted way on specific market segment; the central bank may flatten the yield curve. Conventional monetary policies are defined as a monetary policy strategy in normal times.
	STEP 4	The mandate, structure, functions, and independence of central bank are discussed. The objectives that central banks should pursue are specified in their mandate and they are focused on price stability, output stability, exchange rate stability, and financial stability. The 2008 global financial crisis has revived the idea that financial stability is a main central bank objective, alongside that of price stability. See work card 2.
	STEP 5	We put a special emphasis on monetary policy rules which can be three types – instrument rules (i.e. the Taylor rule), targeting rules (i.e. inflation targeting), and intermediate-targeting rules (i.e. money targeting). Their

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		effect on the monetary policy strategy that a central bank follows is also considered.

ADITIONAL MATERIAL 1 (WORK CARD, PICTURE, RECORDING, QUIZZ, PRESENTATION, ASSIGNEMENTS)

WORK CARD 1 – MONETARY POLICY

You have the following data from the Bulgarian National Bank for 2018 in BGN thousands:

Indicator	Value
Currency outside MFIs	15 560 793
Deposits of other MFIs	15 265 004
Overnight deposits	37 996 409
Deposits with agreed maturity up to 2 years	28 184 639
Deposits redeemable at notice up to 3 months	11 513 343
Marketable instruments (debt securities issued up to 2 years+ MMFs shares/units + repos)	503

(a) Calculate monetary aggregates and monetary base.

(b) Find the deposit multiplier and the narrow and broad money money multipliers if the reserve requirement ratio is 10%. What do the individual money multipliers show?

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ADITIONAL MATERIAL 2 (WORK CARD, PICTURE, RECORDING, QUIZZ, PRESENTATION, ASSIGNEMENTS)

WORK CARD 2 – MONETARY POLICY

Benassy-Quere et al. (2019, pp. 297) presents the following table with the mandates of four central banks:

	Price stability	Exchange rate stability	Output stability	Financial stability
US Federal Reserve	Yes	No, but may intervene on exchange markets	Yes, on an equal footing with price stability	Yes
European Central Bank	Yes	No, but it has the sole right to conduct foreign-exchange operations	Yes, but secondary to price stability	Yes, but as a secondary competence in support to governments
Bank of England	Yes, price stability is defined by the government	No	Yes, secondary to price stability	Yes
Bank of Japan	Yes	No, but may be instructed by the Ministry of Finance to intervene on exchange markets	No, only because of price stability	Yes

Answer the following questions:

1) What are the reasons for making price stability a top priority in the mandate of all mentioned central banks?
2) Why do you think that maintaining exchange rate stability is not a top priority in the mandate of any of the central banks abovementioned?

3) What accounts for the shared responsibility of central banks in terms of price stability and output stability?
4) What are the links between price stability and financial stability? What accounts for the explicit focus on financial stability in central banks' mandates?
5) Considering the mandates of the abovementioned central banks, do you think that one can claim of fiscal dominance or monetary dominance is the leading one?

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