Inside the black box

《總體經濟學》
第 3 版

Lags of effects
The channels of transmission

2008.3
Lags in the effects of monetary policy

The channels of transmission
Monetary policy in practice

in a complex, ongoing process.

• lags in the effects of monetary policy on the economy

• uncertainty about the channels through which monetary policy works
Unanticipated tightening of money

- the Fed funds rate increases within a month, but the effects is transitory
- Real GDP barely responds during the first four months, it then begins to drop sharply. It falls to the lowest level after 18 months
- The response of prices is even slower. The price level does not change during the first 12 months
The long lags

- … makes it very difficult to use the policy instrument with precision
- If FOMC forecast a future inflation, it will reduces current money supply
- but economic forecasts are often inaccurate
Interest rate channel

- A reduction of $M^s$ raises nominal interest rate
- When price level remains constant, real interest rate increases, and both consumption and investment decrease
- exchange rate channel works similarly
credit channel

- A tightening of monetary policy also works by reducing both the supply and demand of credit
- Tight monetary policy reduces bank reserves, and leads to reduced lending by banks
- So, firms and consumers will reduce their spending
credit channel

- On the other hand, when interest rate rises, firm’s cost increases. So firm has troubles obtaining credit.
- The rise in interest rate will reduce stock price. If firm and consumer use stocks as collateral for a bank loan, the lowering in stock price reduces their credit-worthiness.
- Both of the above reduces spending by consumer and firm.