PROJECT: IS MONETARY POLICY EFFECTIVE?

Balancing different economic goals is challenging for the Federal Reserve. Sometimes this institution has to choose between different goals, such as lowering inflation or encouraging economic growth. Then the Federal Reserve carries out monetary policy intended to achieve its goal. But the Federal Reserve's actions do not mean that the goal will be achieved. At times, monetary policy is ***effective***. Other times, actions by individuals, businesses, and governments—both at home and in foreign countries—cause monetary policy not to work as well. For this project, you will figure out whether a certain monetary policy was effective or not in achieving its goal.

VOCABULARY

effective	achieving its intended effect
interest rate	price of money that is borrowed or saved
money supply	amount of money available in the economy, including money in circulation and demand deposits
trend	general direction in which something moves

Project

You have explored how the Federal Reserve carries out monetary policy. You also know that monetary policy involves the ***money supply*** and ***interest rates***. Now, it is time for you to see how effective (or not) monetary policy is in action.

1) Define "monetary policy."

2) The specific action that you will explore is expansionary monetary policy. This is when the Federal Reserve increases the money supply. Explain how increasing the money supply affects interest rates. Then explain how expansionary monetary policy affects consumption, investments, and the growth of the economy.

3) Now it is time to look at a specific monetary policy. You already know about the recession that began at the end of 2007. The Federal Reserve addressed this economic downturn by carrying out expansionary monetary policy. Using the provided document titled "Primary Rates," find the primary interest rate on November 1, 2007.

Primary Rates

	A	B	C	D	
2	Primary* Credit	Secondary** Credit	1 Boston	2 New York	P
3	0.75%	1.25%	19-Feb-10	19-Feb-10	
4	0.50%	1.00%	17-Dec-08	16-Dec-08	
5	1.25%	1.75%	29-Oct-08	29-Oct-08	
6	1.75%	2.25%	08-Oct-08	08-Oct-08	
7	2.25%	2.75%	01-May-08	30-Apr-08	
8	2.50%	3.00%	18-Mar-08	18-Mar-08	
9	3.25%	3.75%	17-Mar-08	17-Mar-08	
10	3.50%	4.00%	30-Jan-08	30-Jan-08	
11	4.00%	4.50%	22-Jan-08	22-Jan-08	
12	4.75%	5.25%	12-Dec-07	11-Dec-07	
13	5.00%	5.50%	01-Nov-07	31-Oct-07	
14	5.25%	5.75%	18-Sep-07	18-Sep-07	
15	5.75% ^	6.25% ^	17-Aug-07	17-Aug-07	
16	6.25%	6.75%	29-Jun-06	29-Jun-06	
17	6.00%	6.50%	10-May-06	10-May-06	

The primary rate is the interest rate available to financially sound banks. To find the primary rate on November 1, 2007, go to the "Primary Rate" column and the row marked "01-Nov-07" in the Boston column. Write down this interest rate.

Next, locate the primary rate on October 29, 2008 (or "29-Oct-08" in the Boston column). This was the primary rate almost one year later. Write down this rate. Examine the interest rates in between these dates.

4) Describe the ***trend*** (or general direction) in the interest rates between November 1, 2007, and October 29, 2008, by answering the following questions:

a. Are the interest rates increasing or decreasing?

b. Does the trend indicate that the Federal Reserve is increasing or decreasing the growth of the money supply during this time?

5) Next, examine consumption, investments, and Gross Domestic Product during 2008 and 2009, using the table below. The table shows the percentage changes in each area. The changes are shown in quarters (or four parts) for each year. For example, the first quarter is January, February, and March.

Quarter and Year	Change in Consumption	Change in Investments	Change in Gross Domestic Product
Quarter 1, 2008	1.0	-3.3	1.9
Quarter 2, 2008	0.6	-7.3	1.2
Quarter 3, 2008	-0.7	-9.7	-0.3
Quarter 4, 2008	-1.9	-17.5	-2.8
Quarter 1, 2009	-1.8	-26.3	-3.8
Quarter 2, 2009	-2.2	-28.5	-4.1
Quarter 3, 2009	-0.9	-24.0	-2.7
Quarter 4, 2009	0.2	-9.6	0.2

Source:
http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=310&Freq=Qtr&FirstYear=2008&LastYear=2010

Explain the trend in consumption, investments, and Gross Domestic Product.

a. Are these areas generally increasing or decreasing during this time?

b. Explain if these trends show that expansionary monetary policy was effective in 2008-2009.

6) Finally, examine consumption, investments, and Gross Domestic Product for three quarters in 2010 using the table below.

Quarter and Year	Change in Consumption	Change in Investments	Change in Gross Domestic Product
Quarter 1, 2010	0.8	10.5	2.4
Quarter 2, 2010	1.7	23.3	3.0
Quarter 3, 2010	1.8	24.1	3.2

Explain the trend in consumption, investments, and Gross Domestic Product.

a. Are these areas generally increasing or decreasing during these quarters?

b. Explain if these trends show that expansionary monetary policy was effective beginning in 2010.

7) There were other actions (including expansionary fiscal policy) that occurred during these times and could also have contributed to economic performance. For this project, assume that the changes in consumption, investments, and GDP occurred (at least in part) from monetary policy.

a. Compare the trends in 2008-2009 to the trends in 2010.

b. Explain the differences in these trends, by discussing the role of timing or confidence.