Answers to Questions for Review

26.1 (a) The Bank might be forecasting that inflation will be on target in two years, even if interest rates are left unaltered, or it might be leaving its inflation targets aside at a time when the economy is in recession.

(b) The Bank might believe that the economy is moving out of recession and that inflation is gathering pace, so by selling securities and reducing the money stock, it will increase interest rates and so ease inflationary pressure.

26.2 No: as explained on page 588, the Bank thinks there would be little effect in the first year.

26.3 (a) This will increase the government’s deficit, or reduce its surplus, which the government might choose to do during those parts of a cycle when output is below its potential level.

(b) This will reduce the government’s own spending and investment by firms, so reducing aggregate demand, which the government might choose to do during those parts of a cycle when output is above its potential level.

(c) This will reduce consumption but increase investment, which the government might want to do in order to increase the growth rate.

26.4 (a) If interest rates are already close to zero, and if the demand for money is highly elastic.
(b) If the growth rate fell at a time when the government’s debt was at the limit.

(c) If the number of people who decided to start work or who worked more hours, was offset by those who believed it was not worth working or who worked fewer hours.