

Homework Assignment 12. Due: Thursday, April 27.

1. (1 point) Explain why inflation can be damaging to an economy?
2. (2 point) Explain how the emergence and growth of electronic money (like PayPal) will affect the ability of central banks to control inflation?
3. (2 points) The main goal of most central banks in the world is price stability. However, some central banks (Federal Reserve, for example) do not specify what exactly “price stability” means. Others (like European Central Bank) define explicit objective expressed in terms of rate of change in specific price index. What are the advantages of the two strategies?
4. (1 point) What are the arguments in favor of central bank independence?
5. (2 point) Read the summary of the most recent Beige Book (<http://www.federalreserve.gov/fomc/beigebook/2006/20060315/default.htm>). In a few sentences summarize the main points of the report.
6. (1 points) Suppose that the Fed buys \$1 bln worth of French government bonds denominated in Euros, paying in dollars. What is the impact on the monetary base? What would the Fed have to do to keep the monetary base unchanged?
7. (1 point) The Central Bank of China often buys US dollars from Chinese businesses which sell their products in US. In a T-account show what is the effect of one such transaction (worth, say, \$1 mil) on the Central Bank’s balance sheet?