

Tasks

(a) With the help of the data provided on the UK economy, describe the trend in inflation rate between 1997 – 2003 and discuss the possible link between inflation rate and growth rate. [10]

Describe the trend (total =2m):

Direction [1m]:

falling rising (2002-2003)
downward trend then rising trend
1997 to end 2001

Level [1m]:

1997 to 1999 : above target 2.5%
1999 to 2002 : within control (below 2.5%)
2003 onwards : above 2.5%

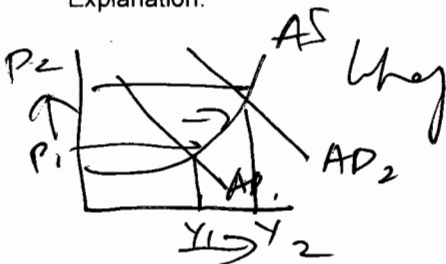
Inflation rate versus Growth rate

highly correlated - both falling trend then rising trend
Crawbar shaped

Possible link?

AD/AS relationship in relation to price levels: [4 marks]

Explanation:



Growth rate ↑ AD ↑
GPL ↑
GPL ↑
DD pull inflation

Hiccups / exceptions [3 marks]

[Notably the "hump between 1999-2001 for growth rates and the sudden surge in inflation rates between 2002-2003]. The explanation probably lies in the role of monetary policy.

because of delay effect
of easy MP of ↓ i/r
7x
bet 1998 to 1999

→ MP v powerful + effective in
inflation growth + inflation rate
~ UK

(b) Discuss the relevance of the three indicators in Table 1 used by the Monetary Policy Committee in its decision making process. [10]

The Role of Monetary Policy in relation to the 3 economic goals

The table below provides a framework to link up all the relevant elements.

Indicators	Relevance (How it is linked to i/r?)	Relevance (In relation to objectives of monetary policy)	Drawbacks (Irrelevance?)
GDP fear recession Slowdown	ant i/r Tx C ↑ I ↑ AD ↑ Y ↑	growth	GDP → does tell us abt AS i/r → direct effect on AD unless IT (LAST)
Inflation Rate fear inflation	i/r ↑ I ↓ C ↓ AD ↓ Y ↓ GPL ↓	Stability Stabilization goal	only applicable for 3D model inflation Cannot avoid cost push only if C, I are interest elastic
Current balance (basically reflects the BOT) date worsening current balance Draft	i/r ↓ outflow of hot \$ weaken the £	Stability to stabilise b/p position	Is exs rate the ONLY factor affecting net X? Px EL for X if Px ↓ Q _{net} (el)

quality
innovation
Tech
Trade Barriers
Protectionism
Tariff

(c) With the help of the data provided, critically examine the effectiveness of using Monetary Policy in stabilizing the economies of UK and Japan. [10]

Context:

Economic stabilization

This broadly should cover both inflation and growth objectives.

Students should evaluate both in their analysis.

Evaluate effectiveness of Monetary Policy in UK: (5m)

Key Economic Indicators	Underlying reasons (Why?)
Inflation Rate: Mostly <u>below</u> target of 2.5% 1 yrs - 3 yrs below 2.5% 1997 - 2003	Why MP is effective? C, I interest elastic +ve investors' confidence Confidence in banking sector
Growth Rate: Mostly above the average rate of 2.4% Healthy	
Overall Assessment: Creditable achievement: healthy growth rates + benign inflation rates "Soft-landing"	

below 2.5%

Evaluate effectiveness of Monetary Policy in Japan: (5m)

Key Economic Indicators	Underlying Reasons
Inflation Rate: Negative [deflation]	zero i/r financial institution failure No confidence NPLs - C, I Liquidity Trap?
Growth Rate: Negative [recession] In fact it has been negative for over a decade!	
Overall assessment: Dismal failure Monetary Policy = impotent.	

Not interest el.

Conclusion: