HULT International Business School
Economy Theory & Application (ECN102) - A. Wright
Final Exam Essay Answers Type

2. Bubbles - Deflation - Monetary Policy

After the 2008 crash governments enacted extreme and unconventional monetary policy measures. Explain these and how they were supposed to work.

Introduction:
After the financial crash of 2008, the economy fell apart, it faced stagnation, high unemployment and a deep recession. These structural issues could not be solved by the conventional policies that did not work. Instead, central banks used unconventional monetary policies to stimulate the economy. These included quantitative easing, credit or qualitative easing,operation twist, precommitment policies and negative interest rates.

(I) **Quantitative easing** is a measure used by central banks to increase the money supply by buying long term bonds or securities with newly printed money to other banks and financial institutions. This is done by controlling the yield curve. Quantitative easing pushes down the yield curve which lowers interest rates for investors whose investments will stimulate the asset markets and the economy.

(II) **Qualitative easing** also called **credit easing** is another type of extreme monetary policy. Central banks buy non-governmental long term bonds and securities (such as mortgage backed securities and treasury bonds) from private financial companies to change the quality of the securities it holds, with more risky assets. The purpose of this policies is to diversify the quality t the assets bought by the central banks who will then insert this into the economy without the intervention of banks.

(III) **Operation twist** is a tool of the credit easing. Central banks will also diversify their assets portfolio by selling short term treasury bills to buy long term treasury bonds. This method differs from qualitative easing because the banks do not buy private securities. The purpose of this tool is to twist the yield curve and drive down interest rates to make businesses borrow more, spend more and hire more . In fact, buying long term bonds help the central banks push interests up and yields down. Selling short term debts will increase the yields and decrease interests rates. This tool was used because quantitative easing was increasing the quantity of money on the market, increasing inflation risks.

(IV) **Negative interest rates** is another stimulus used by central banks. This monetary process involves charging commercial banks for money deposits at the federal reserve. Central banks believe this may increase lending and therefore stimulate the economy. This method has been used by the Banks of Japan to cope with deflation and increase the level of consumption and investment .

<Conclusion>