

# Chapter 23

## Monetary Policy, Output, and Inflation in the Short Run

McGraw-Hill/Irwin

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### The Monetary Policy Transmission Mechanism

- The Traditional Channels: Interest Rates and Exchange Rates
  - the traditional channels of monetary policy transmission aren't very powerful

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### The Monetary Policy Transmission Mechanism

- Asset Price Channels: Investment and Wealth
  - a fall in the interest rate tends to push stock prices up
  - A fall in interest rate target it drives the mortgage rate down leading to higher demand for residential housing, driving up the prices of existing homes
- Higher asset prices mean increased wealth and higher consumption

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## The Monetary Policy Transmission Mechanism

- Bank Lending and Balance Sheet Channels
  - By altering the supply of funds to the banking system, policymakers can affect banks' ability and willingness to lend.
  - an open market purchase has a direct impact on the supply of loans, increasing their availability to those who depend on banks for financing.
- as interest rates fall, the supply of loans increases

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## The Monetary Policy Transmission Mechanism

Table 23.1 The Monetary Policy Transmission Mechanism

Channel	Mechanism
Interest rates (traditional channel)	Lower interest rates reduce the cost of investment, making more projects profitable.
Exchange rates (traditional channel)	Lower interest rates reduce the attractiveness of domestic investment, depressing the value of the currency and increasing net exports.
Asset prices	Higher stock prices and real estate values fuel an increase in both business investment and household consumption.
Bank lending	An easing of monetary policy raises the level of bank reserves and bank deposits, increasing the supply of funds.
Firms' balance sheets	Lower interest rates raise firms' profits, increasing their net worth and reducing the problems of adverse selection and moral hazard.
Household net worth	Lower interest rates raise individuals' net worth, improving their credit-worthiness and allowing them to increase their borrowing.

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## Chapter 23

End of Chapter

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