Monetary Policy

Economics

How a central bank influences demand, and the lags involved.

Transmission and constraints.

Transmission channels

- Cost of borrowing for firms and households
- Incentive to save rather than spend
- Asset prices and wealth effects
- Exchange rate and net exports
- Expectations of future policy

Constraints

- Long and variable lags, often 12-24 months
- Lower bound near zero interest rates
- Cannot target regions or sectors
- Blunt — affects everything at once

> Educational reference. Because of the lags, policy must act on a forecast, which is why it is sometimes wrong in hindsight.