2.15 Central Banks and the Tools of Monetary Policy: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for the 25-mark question and for any explanation worth more than 2 marks. Time guidance: 10 minutes.

1 Function of the central bank in a UK-style financial system: state and explain the meaning of the central bank acting as 'lender of last resort' for commercial banks during a liquidity crisis.

(Total for Question 1 is 2 marks)

2 Monetary Policy Committee independence: state the main purpose of giving the Monetary Policy Committee (MPC) operational independence in setting Bank Rate in the UK-style system.

(Total for Question 2 is 2 marks)

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3 Quantitative easing (QE): define QE as used by a modern central bank and state one type of asset the central bank typically purchases when conducting QE.

(Total for Question 3 is 2 marks)

4 Explain one limitation of describing the central bank only as 'guardian of financial stability' and not mentioning its other functions such as issuing currency or operating as banker to the government.

(Total for Question 4 is 2 marks)

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Mark scheme · 2.15 Central Banks and the Tools of Monetary Policy: 10-minute Pack

Question 1

provides emergency short-term loans to solvent but illiquid commercial banks to prevent bank runs and wider systemic failure **B1**

this support stabilises the banking system by supplying liquidity while longer-term solutions are arranged, reducing contagion risk **B1**

Answer: The central bank lends short term to solvent but illiquid banks to prevent runs and limit systemic collapse, stabilising the banking system.

Question 2

to allow decisions on Bank Rate to be based on economic evidence and inflation forecasts rather than short-term political pressures **B1**

to help anchor inflation expectations by committing the MPC to an explicit inflation target **B1**

Answer: Independence lets the MPC set Bank Rate based on economic evidence rather than politics, helping to anchor inflation expectations around the inflation target.

Question 3

QE is when the central bank creates central bank reserves or money to buy financial assets in order to increase the monetary base and lower long-term yields **B1**

a common asset purchased is government bonds, especially long-dated sovereign debt **B1**

Answer: QE is creating central bank money to buy assets and increase the monetary base; the central bank typically buys government bonds.

Question 4

identifies that the central bank has multiple functions beyond financial stability, such as issuing currency and acting as banker and lender of last resort **B1**

explains that focusing only on stability understates roles in payment systems, government finance and monetary policy implementation **B1**

Answer: Calling the central bank only the guardian of financial stability omits its roles in issuing currency, running the payments system and acting as banker and lender of last resort, so it understates how it manages money and supports government and banks.

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