2.16 The Monetary Policy Transmission Mechanism and Its Evaluation: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Show working for calculations where required. You have 10 minutes in total.

1 Explain how long and variable time lags in monetary policy transmission limit the policy's ability to close a negative output gap. Give two linked points about the nature and consequences of lags.

(Total for Question 1 is 3 marks)

2 Explain, in the context of ECO.MAC14, how a cut in Bank Rate can lead to higher consumer spending via the consumption channel. Set out the causal steps briefly.

(Total for Question 2 is 3 marks)

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Mark scheme · 2.16 The Monetary Policy Transmission Mechanism and Its Evaluation: 10-minute Pack

Question 1

identifies that there are recognition, decision and implementation lags plus long transmission and impact lags before policy affects output	**M1**
explains that because lags are long and uncertain, monetary policy may take effect after the output gap has partly or fully closed, potentially destabilising the economy or causing inflation later	**A1**
adds that variable lag length makes it hard to calibrate policy size and timing, weakening confidence that policy will reliably close a given negative output gap	**A1**

Answer: Monetary policy faces long recognition, decision and transmission lags so its effects on output are delayed and uncertain; this means policy may act too late or overshoot, limiting its reliability in closing a negative output gap.

Question 2

Bank Rate cut puts downward pressure on market interest rates for mortgages, credit cards and personal loans	**M1**
lower interest payments increase disposable income for households with variable-rate debt and reduce the cost of new borrowing	**A1**
higher disposable income and cheaper credit raise consumption, shifting aggregate demand to the right	**A1**

Answer: A lower Bank Rate reduces market interest rates, lowering mortgage and loan payments and making borrowing cheaper; households therefore have higher effective disposable income and face cheaper credit, which increases consumption and shifts AD rightwards.

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