

Tutorial 12: Policy Timing, Deficit Targeting, and Stock Market Effects

- 1) What is the most important determinant of the response lag for monetary policy?
- 2) Explain why the time lags, in general, pose a challenge to policy makers.
- 3) Explain why is the response lag for monetary policy likely longer than the response lag for fiscal policy?
- 4) Explain stagflation and the policy dilemma it presents.
- 5) Explain how the Central Bank responds to the following two situations: (1) low output and low inflation and (2) high output and high inflation.
- 6) Assume that government spending is reduced by RM10 billion, the value of the expenditure multiplier is 2, and the DRI is -0.25 . What is the net effect of the spending decrease on the deficit?
- 7) Suppose government spending is reduced by RM100 billion. Explain what effect this reduction in government spending will have on the size of a budget deficit. Specifically, does the deficit increase or decrease? And, is any change in the deficit equal to, larger than, or smaller than RM100 billion?