

**Short question**

(250 words each)

1. What is the difference between an asset and a commodity? Under what conditions can a commodity turn into an asset?
2. What has been the trend in gold and silver prices in the last few years. Provide and explanation for the price movements.
3. What led to the money demand becoming unstable since the 1970s?
4. What is the money multiplier? Explain what determines its size.

**Essay**

(500 words)

The United Kingdom has been suffering from high inflation. Discuss how the implementation of contractionary monetary policy by the Bank of England is likely to affect the UK yield curve and economic activity.

**Problem**

1. Suppose the Bank of England's repo rate is  $4\frac{1}{2}\%$  and the financial pages in the newspaper in 2005 contain the following information:

UK GILTS	Interest Yield	Redemption Yield
Tr $7\frac{1}{2}$ pc '06*	7.32	4.31
Tr $4\frac{3}{4}$ pc '10	4.65	4.22
Tr 8 pc '15	6.09	4.09
Tr $4\frac{1}{4}$ pc '55	3.76	3.68

\*A bond maturing in 2006 with a coupon rate of  $7\frac{1}{2}\%$ .

- (a) Compute the price of the Tr  $7\frac{1}{2}$  pc '06 Treasury gilt per £100 face value. Explain how this gilt price is likely to be affected if the Bank of England reduced the repo rate by 25 basis points.
- (b) Draw the yield curve. Provide at least two reasons why the yield curve could have that shape.

- (c) Assuming the expectations theory of the term structure holds, estimate the 5-year interest rate in 2010. Explain why there may be a term premium that increases with the term to maturity and how that would affect the estimate.

[Tripos 2006]

## Main readings

Mishkin (2004). *The Economics of Money, Banking and Financial Markets*, chapters 4–7.

## Supplementary references

Bofinger (2001). *Monetary Policy: Goals, Institutions, Strategies and Instruments*. Appendix 8.1–8.4.

De Bondt and Thaler (1989). *Anomalies: A Mean-Reverting Walk Down Wall Street*, *Journal of Economic Perspectives* 3(1), Winter, pp. 189–202.

<http://www.jstor.org/stable/info/1942972?seq=1>

Estrella and Mishkin (1996), *The Yield Curve as a Predictor of U.S. Recessions*, *Federal Reserve Bank of New York, Current Issues in Economics and Finance* 2(7), June, pp. 1–6.

[http://www.newyorkfed.org/research/current\\_issues/ci2-7.pdf](http://www.newyorkfed.org/research/current_issues/ci2-7.pdf)

Haldane and Read (1999). *Monetary Policy and the Yield Curve*. *Bank of England Quarterly Bulletin*, May.

<http://www.bankofengland.co.uk/publications/quarterlybulletin/monpolyield.pdf>

Howells and Bain (2005). *The Economics of Money, Banking and Finance: A European Text*. chapter 16.

Hubbard (2002). *Money, the Financial System, and the Economy*. chapter 3–7.

Peacock (2004). *Deriving a market-based measure of interest rate expectations*. *Bank of England Quarterly Bulletin* (Summer).

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