Financial Markets, Goods Market and expectations

Exercises

Economics II – Lecture 4

Lecturer: dr. Andrea Venegoni

Exercise 1:

Consider the stock market of country Alpha. What happens on the price of stocks if:

- The central bank of aalpha implements a contractionary monetary policy;
- The government of Alpha announces a tax cut for the current year;
- The financial market expect a future tightening of the credit conditions due to a decrease in individuals' confidence in the banking system soundness;
- The financial markets expect an upcoming recession period;

Exercise 2:

True or false:

- Monetary policies have certain effects on stock prices, while fiscal policies do not;
- Monetary policies have certain effects on bond prices, while fiscal policies do not

Exercise 3:

Let's suppose that the one year bond yield are equal to 2%, while the yield on two year bonds is 2.5%.

- Draw the yield curve line and compute the one year bond yield expected in t+1.
- Suppose that the announcement of a future monetary contraction raises the future interest rates while causing a future income drop, meanwhile decreasing current rates. Which will be the shape of the new yield curve?

Exercise 4:

Imagine that initially the yield curve is flat. What should happen for the following facts to verify:

- Yield curve becomes flat;
- Yield curve becomes downward sloping;
- Yield curve becomes steeper ("more upward sloping");

Exercise 5:

Explain how the following facts affect the different component of total wealth and/or the current disposable income:

- A drop in the demand for new houses;
- A permanent increase in the taxation;
- A stock market crash;
- A labour reform that increases wages for all workers;