

Taylor, expectations open market operations and changes in the Federal Funds rate:

The purpose of the paper is to give some insight into the realities of how the Fed (tries to?) sets interest rates, a subject of great mystery in Friedman's analysis, and to explore a model that generates "open mouth" operations.

Taylor questions

- When did the Fed start announcing the funds rate target? When did it start giving information about future funds rate "direction"
- Explain lagged reserve accounting. How much reserves do you have to have when, to cover how much M1 when?
- What has the effect of sweep accounts been on required reserves and why?
- What is the purpose of the model in this paper?
- What are fed funds and what does the fed funds rate mean?
- If you have too many Fed balances, why lend them out rather than, say simply buy a T bill? If you have too few, why borrow them rather than sell a t bill or, better, yet, repo a t-bill? (Repo: sell a t bill, promise to buy it back the next day. It's just like borrowing with T bill as collateral)
- Why keep (non-interest paying) balances at the Fed at all? If a check comes in, then send money to the Fed to cover it, or borrow from the Fed.
- What exchange are Federal funds traded on?
- When does the Fed do Open Market operations? What does it actually do – does it borrow/lend fed funds or what?
- How can the Federal funds rate be *any* different than the target?
- The flow in FF market is more than 10 times the stock of Fed balances. (150 b / day) Why might a bank borrow 4 billion in FF on a day when its FF balances are only 100 million?
- Does every transaction take place at the same rate?
- What's the point of Figure 1?
- Are deviations of ff from the target persistent, iid, or somewhere in between?
- At the turn of the century, does it look like banks demands for reserves surprised the Fed, or does it seem that the Fed pumped in a lot of reserves, temporarily not worrying about the target?

- What's the point of figure 4?
- Explain the intuition of (2)

$$b_t = b_{t-1} + \beta(r_{t-1} - \rho_{t-1})$$

- What is the slope of the balance supply curve in (2)? How is this different from classic money supply stories?
- Why might the fed funds rate be a random walk (hint: inside a maintenance period.)

$$r_t = E_t r_{t+1}?$$

- Explain Figure 5.
- Does Taylor's model give a pure open mouth operation, with no open market operations
- What do you think happens in the Taylor model if the market *expects* the rise in the funds target.
- What's the point of Figure 6?
- Why does the Fed fix the quantity of reserves, rather than simply announcing an interest rate and letting banks have all they want at that rate (effectively, open the discount window)?