Econ 423 Michael Salemi

"Longer-Term Perspectives on the Yield Curve and Monetary Policy"
Sharon Kozicki and Gordon Sellon
Federal Reserve Bank of Kansas City Review
Discussion Questions

1. How do the authors support their conclusion that "...the recent behavior of long-term interest rates is unusual...." (p. 6)?
   a. What is the conundrum that the authors are trying to explain? Why is it a conundrum?
   b. How does Chart 1 embody the conundrum?
   c. How do charts 2 and 3 embody the conundrum?
   d. What do the authors mean by "pivoting", "rotation", and "shifting" of the yield curve?
   e. How would the authors use the terms pivoting, rotation and shifting to explain the conundrum?

2. Why, according to the authors, does the expectations hypothesis "...provide(s) a simple way to link monetary policy actions to fluctuations of bond yields...." (p. 13)?
   a. How, according to the authors, can differences in near-term expectations of policy and longer-term expectations of policy help explain the behavior of the yield curve?

   b. What do the authors mean by "near-term" and "longer-term" expectations of policy?

   c. What do the authors mean by a "term premium" and how can changes in the term premium affect the shape of the yield curve?

3. According to the authors, what sort of monetary policy changes can explain pivoting, rotation, and shifting of the yield curve?
   a. How do the authors use Table 1 to explain the effects of policy tightening?

   b. How do the authors use Charts 6, 7, and 8 to explain the effects of policy tightening? What sort of policy change is behind each chart?

4. In the conclusion, the authors say that the key difference between the behavior of interest rates in 1999-2000 and in 2004-2005 is the behavior of financial market estimates of the neutral federal funds rate. How do the authors reach this conclusion?
   a. What do the authors mean by the "neutral federal funds rate"?

   b. How do the authors quantify the relative importance of the various economic factors that might lie behind the difference responses of interest rates to policy tightening in these two periods?

   c. What is the intuition behind the equation Forward Rate = Real Rate + Expected Inflation + Inflation Risk Premium + Other Risk Premium that the authors present on page 21?

   d. How do the authors estimate the contribution of these four terms to changes in the forward rate?

   e. Why do the authors think that interest rates responded differently to monetary tightening in 2004-05 than they did in 1999-2000?