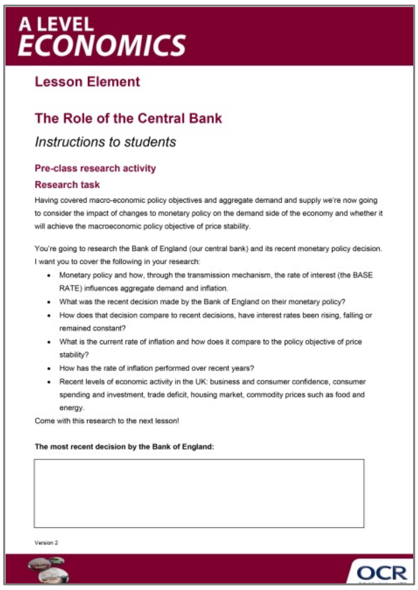
Lesson Element

The Role of the Central Bank

Instructions and answers for teachers

These instructions should accompany the OCR resource 'The role of the central bank' activity *which supports OCR A Level Economics.*


A LEVEL
ECONOMICS

Lesson Element

The Role of the Central Bank

Instructions to students

Pre-class research activity

Research task

Having covered macro-economic policy objectives and aggregate demand and supply we're now going to consider the impact of changes to monetary policy on the demand side of the economy and whether it will achieve the macroeconomic policy objective of price stability.

You're going to research the Bank of England (our central bank) and its recent monetary policy decision. I want you to cover the following in your research:

- Monetary policy and how, through the transmission mechanism, the rate of interest (the BASE RATE) influences aggregate demand and inflation.
- What was the recent decision made by the Bank of England on their monetary policy?
- How does that decision compare to recent decisions, have interest rates been rising, falling or remained constant?
- What is the current rate of inflation and how does it compare to the policy objective of price stability?
- How has the rate of inflation performed over recent years?
- Recent levels of economic activity in the UK: business and consumer confidence, consumer spending and investment, trade deficit, housing market, commodity prices such as food and energy.

Come with this research to the next lesson!

The most recent decision by the Bank of England:

Version 2

OCR

Introduction to the flipped classroom approach

The flipped classroom is a pedagogical model in which traditional classroom and homework activities are reversed. Short video 'lectures' are viewed by students at home before the class session, while in-class time is devoted to exercises, projects, or discussions. The structured video lecture is often seen as the key ingredient in the flipped approach with the materials either created by the instructor or selected from existing materials online and structured with targeted questions for students to complete. The value of a flipped class is in the repurposing of class time into a workshop where students can test their skills in applying knowledge, and interact with one another in hands-on activities. During class sessions, teachers act as facilitators supporting students in applying their knowledge rather than didactic 'providers of knowledge'. Adapted from: Things You Should Know About Flipped Classrooms, EDUCAUSE - http://net.educause.edu/ir/library/pdf/eli7081.pdf

Associated materials:

The Role of the Central Bank' activity

This activity offers an opportunity for English skills development.

OCR
Oxford Cambridge and RSA

Task instructions

The objective of the lesson is to learn about the *role of the central bank*. This is a component within the Financial Sector section of the specification. The lesson provides the opportunity for students to engage in independent learning by using the flipped classroom approach. Before the lesson students should carry out the research task on the recent monetary policy decision made by the Bank of England and how this compares to past decisions on issues like interest rates or quantitative easing. At this stage they should not know how they will use the information. They may need some guidance on where to find materials depending upon the nature of/abilities within the group. There will be a need to update the first line of the student sheet to account for the most recent decision by the Bank of England.

When students enter the classroom for the lesson they should be told that they are journalists who are attending a press conference held at the Bank of England. Their teacher has the role of the governor of the bank. In small groups (between 4 or 5) they pool their research and devise five questions to pose to the governor. The purpose of the questions is to glean further information about the rationale behind the decision and implicitly to grasp a deeper understanding of the role of the central bank. This should take about 10 minutes. They join together as one class once the 10 minutes is up and ask their questions to the 'governor'. Once the questions have been asked and answered they return to their groups and decide whether they agree with the decision. Once they've formed that judgement they return to the floor and debate as a whole group whether the decision was right or not with the teacher acting as facilitator. The lesson can end with a vote on whether they as a class agree with the Bank's decision on monetary policy or not.

Teacher preparation for their role in activity

A summary of key information and background to the topic

The topic is covered with the backdrop of macro-economic performance and using policy instruments to achieve a macro-economic policy objective: price stability.

Monetary Policy is used to influence the demand side of the macro-economy. It seeks to promote price stability and economic activity through influencing the level of aggregate demand. The Bank of England's Monetary Policy Committee meets once a month (on the first Thursday of the month) to vote on whether the central rate of interest (the BASE rate) should remain the same, increase or decrease. Rate changes are normally incremental; historically the interest rate has changed by 0.25 percentage points. However, since the financial crisis the rate of interest was reduced to unprecedented levels of 0.5%. Since the crisis the Bank has engaged an Asset Purchase Scheme – quantitative easing – and when Mark Carney came in as Governor, a programme of forward guidance. He said that interest rates would be reviewed once unemployment fell to 7%. These were both new monetary policy tools for the Bank of England.

Students should know the basics of the role of the Bank of England before the debate on its monetary policy decisions. They should also have knowledge of:

- the Monetary Policy Committee (MPC), and some awareness of how they make decisions on the rate of interest.
- the macro-economic policy objective of the MPC: the inflation target and price stability.
- aggregate demand (and aggregate supply) and how changes to monetary policy affect the demand side of the macro-economy.
- money supply, how changes in money supply can be brought about and their impact on inflation.

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Types of questions students might ask

What were the key factors that lead you to making the decision?

When making a monetary policy decision the MPC will consider: its inflation and GDP projections (using fan charts in order to gauge the probability of various outcomes). This will give the probability of various outcomes for inflation and GDP growth. The MPC is helped through the use of business surveys and agents that report on the outlook for the economy.

Were external/international factors more significant than internal/domestic ones?

The answer to this question depends upon the economic situation at the time of the lesson but it is important to highlight the importance of commodity prices such as oil and energy, the performance of the exchange rate and whether any inflationary pressures are coming from within the economy, from external sources or whether we are importing deflationary pressure due to cheaper imports.

What impact do you expect this to have upon the rate of inflation?

Reference should be made to the most recent inflation report and the monetary transmission mechanism. An increase in the rate of interest (contractionary monetary policy) will result in a fall in aggregate demand and of course a fall (expansionary policy) will result in a rise in aggregate demand.

What impact do you expect this to have on the level of aggregate demand and unemployment in the economy?

Make use of recent information on unemployment figures (the BBC website is a great help here) and consider whether aggregate demand should rise or fall in response to the interest rate change. As demand for labour is derived from demand for the products they produce there should be a fall in unemployment if interest rates fall and aggregate demand increases. A nice chance to question the type of unemployment and other factors that might influence whether unemployment does change and to what extent.

How long do you expect the time lag to be between making your decision and seeing an impact on inflation?

The general rule of thumb for the time lag between an interest rate decision and a change in output and inflation is 1 year and 2 years respectively. Increasing interest rates by 1% for one year might be expected to lower output by 0.2%-0.35% over one year and decrease inflation by 0.2 – 0.4 percentage points.

How might the decision affect our exchange rate and thus the price competitiveness of our exports?

A rate rise will lead to an appreciation of the exchange rate and thus make exports less price competitive. This will obviously make a negative contribution to aggregate demand. Students may need some idea of how hot money flows affect the value of a currency if they haven't covered that section of the course.

Who will be the winners and who will be the losers from this decision?

Students need to be aware that different sub-groups within society will lose while others gain from the rate decision. They should consider how the impact of the decision may depend upon the marginal propensity to consume and save, whether people are home owners or not and how those who are reliant on savings for income may be more sensitive to changes in the rate of interest.

Key places to look for information

www.bankofengland.co.uk
www.guardian.co.uk
www.bbc.co.uk/news

Classroom activity – Brief

Teacher: "You are going to be taking on the role of journalists and I am assuming the role of the Governor of the BoE at a press conference. This is held once the Monetary Policy Committee has announced their monetary policy decision for this month. Your job is to glean enough information to be able judge whether you agree with the monetary policy decision. (You'll be writing a newspaper report after today's lesson.)

To begin with, in groups of four (or five), I want you to pool together your research and decide five questions you'd wish to ask the Governor. This is to help you understand the rationale behind the MPC decision. You'll have about 10 minutes to do this and then we'll convene back as a whole class. This is the press conference and time to ask your questions. Once every group has had the chance to ask their questions (and it may be that you ask the same ones so take notes from the answers others get) you'll return to your small groups to form your judgement on whether you agree with the MPCs decision or not. We are going to hold a debate about the BoE's decision, so make sure you can argue your position: I do expect everybody to participate in that debate!

At the end of the lesson we'll have a group vote on whether we agree or not.

Remember what you know about the factors taken into account by the MPC when making monetary policy decisions, the objectives the MPC has and the recent macroeconomic performance of the UK economy as well as other economies that influence our performance indicators. You should be able to compare this decision to ones made in the past and how it either fits with or seems out of step with previous monetary policy movements."

Note for the teacher: Monetary policy decisions will include: interest rates and perhaps quantitative easing, forward guidance or other monetary policy measures.

If students don't come up with five questions it doesn't matter too much, as long as they are asking about the reasons for the decision and the impact that the Governor thinks it will have on the macroeconomic performance of the UK. Try to be quite flexible with timings; timings will depend upon the length of your lesson, size of group and their enthusiasm. If some come without their research, hopefully the groups will be able to still have enough knowledge to generate some questions. This could be an opportunity to differentiate through the composition of the groups.

Writing down the decision made by the MPC on the whiteboard or on a PPT could help remind students. And, recording their main points at the end on the whiteboard will give them pointers of what to include in their write up.

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