

15-5. monetary policy

15-5.1. Definition: Monetary policy is the process by which the government, central bank, or monetary authority manages the supply of money, or trading in foreign exchange markets.

15-5.2. Kinds of Monetary policies: there are two kinds of monetary policies can government apply them to deal with the economic problems:

- Expansionary policy: an expansionary policy increases the total supply of money in the economy, and it is traditionally used to reduce unemployment in a recession by lowering interest rates.
- Contractionary policy: a contractionary policy decreases the total money supply, and it has the goal of raising interest rates to reduce.

15-5.3 .Monetary policy tools:

- Monetary base: Monetary policy can be applied by changing the size of the monetary base. This directly changes the total amount of money circulating in the economy. A central bank can use open market operations to change the monetary base. The central bank would buy/sell bonds in exchange for hard currency. When the central bank gives out /collects this hard currency payment, it changes the amount of currency in the economy, thus changing the monetary base.
- Reserve requirements: The monetary authority uses regulatory control over banks. Monetary policy can be applied by changing the proportion of total assets that banks must hold in reserve with the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. By changing the proportion of total assets to be held as liquid cash, the Federal Reserve changes the availability of loanable funds. This acts as a change in the money supply.

- Discount window lending: Many central banks or finance ministries have the authority to lend money to financial institutions within their country. By calling in existing loans or extending new loans, the monetary authority can directly change the size of the money supply.
- Interest rates: The contraction of the monetary supply can be achieved indirectly by increasing the nominal interest rates. Monetary authorities in different nations have differing levels of control of economy-wide interest rates. In the United States, the Federal Reserve can set the discount rate, as well as achieve the desired Federal funds rate by open market operations. This rate has significant effect on other market interest rates, but there is no perfect relationship. In the United States open market operations are a relatively small part of the total volume in the bond market.

15-6. Types of Money: The most important types of money are:

- commodity money: The value of commodity money is about equal to the value of the material contained in it. The principal materials used for this type of money have been gold, silver, and copper.
- credit money: Credit money is paper backed by promises by the issuer, whether a government or a bank, to pay an equivalent value in the standard monetary metal, such as gold or silver. Paper money that is not redeemable in any other type of money and the value of which is fixed merely/just by government edict is known as fiat money.
- fiat money: Credit money becomes fiat money when the issuing government suspends the convertibility of credit money into precious metal. Most fiat money began as credit money, such as the U.S. note known as the greenback, which was issued during the American Civil War. Most minor coins in circulation are also a form of fiat money, because the value of the material of which they are made is usually less than their value as money.

Questions:

1. Give the definition of Money?
2. Make a comparison between money and barter?
3. List the three Essential characteristics of money?
4. List the Many types of money?
5. Give a definition of Electronic money?
6. Make a comparison between the Expansionary monetary policy and Contractionary monetary policy?
7. Translate the following paragraph:-

Money

The central bank usually has three main mechanisms for controlling the money supply. It can sell treasury securities, which reduces the money supply (because it accepts money in return for a promise to pay in the future). It can also purchase treasury securities, which increases the money supply (because it pays out hard currency in exchange for accepting securities). Finally, the central bank can adjust the reserve requirement. The reserve requirement is directly related to the money multiplier (When interest rates go down, money supply increases. Businesses and consumers have a lower cost of capital and can increase spending and capital development projects. This encourages growth. Conversely, when interest rates go up, the money supply falls. The central bank increases interest rates to reduce inflation).