

Bank rate of the bank of canada

[Finance](#), [Banks](#)



ECON 248 Assignment 2 1. The bank rate is the interest rate at which the Bank of Canada stands ready to lend reserves to chartered banks. The banker's deposit rate is the interest rate that the Bank of Canada pays banks on their deposits at the Bank of Canada. Changes to these rates by the Bank of Canada typically spread to other interest rates and therefore will influence the amount of lending done by the banks. An open market operation is the purchase or sale of government securities, which are government of Canada Treasury bills and bonds, in the open market by the Bank of Canada.

These transactions done by the Bank of Canada change the reserves of the banks, which have an immediately impact on the amount of overnight borrowing. This enables the Bank of Canada to hit its overnight rate target. Government deposit shifting is the practice of shifting government deposits between the government's account at the Bank of Canada and its accounts at the various chartered banks. These shifts of deposits affects the banks' reserves, and therefore their ability to make overnight loans.

Since this tool is typically used on a small scale to smooth daily fluctuations in the amount of overnight loans, its impact on the implementation of monetary policy is small. The required reserve ratio is the portion of depositors' balances banks must have on hand as cash, as determined by the central bank. The monetary policy of a required reserve ratio is no longer in use by the Bank of Canada. The Bank of Canada's policy tools work by changing the quantity of money in the economy, by changing the monetary base.

By raising the bank rate, the Bank of Canada can make it more costly for the banks to borrow reserves. By raising the interest rate it pays the banks on their own deposits at the Bank of Canada, it can induce the banks to want to hold larger reserves. By selling securities in the open market, the Bank of Canada can decrease the monetary base. The Bank of Canada can also decrease bank reserves and the monetary base by switching some government of Canada deposits from a chartered bank to itself. These actions decrease the quantity of money, other things remaining the same. . $L = (1 - 0.35) \times (1 - 0.07) L = 0.6$ Quantity of money created = \$50,000,000 $\times 1/(1 - 0.6)$ Quantity of money created = \$50,000,000 $\times 2.5$ Quantity of money created = \$125,000,000 3. a) The multiplier is the amount by which a change in any component of autonomous expenditure is magnified or multiplied to determine the change that it generates in equilibrium expenditure and real GDP. Investment expenditures increase aggregate expenditure and real GDP. The increase in real GDP increases disposable income, which increases consumption expenditure.

The increased consumption expenditure adds even more to aggregate expenditure. Real GDP and disposable income increase further, and so does consumption expenditure. The initial increase in investment brings an even bigger increase in aggregate expenditure because it induces an increase in consumption expenditure. The multiplier determines the magnitude of the increase in aggregate expenditure that results from an increase in investment or another component of autonomous expenditure. The greater the marginal propensity to consume, the larger is the multiplier.) The marginal propensity to import and the marginal tax rate together with the

marginal propensity to consume determine the multiplier. Their combined influence determines the slope of the aggregate expenditure curve. Since $\text{Multiplier} = 1 / (1 - \text{Slope of AE curve})$ and the marginal tax rate determines the extent to which income tax payments change when real GDP changes, the size of the multiplier will decrease depending on the extent to which the marginal tax rate reduces the slope of the AE curve.) The slope of the AE curve equals 0.75 $\text{Multiplier} = \text{change in real GDP} / \text{change in investment} = 1 / (1 - \text{MPC})$ $\text{Multiplier} = 1 / (1 - 0.75) = 1 / 0.25 = 4$ The revised slope of the AE curve equals 0.45 $\text{Multiplier} = \text{change in real GDP} / \text{change in investment} = 1 / (1 - \text{Slope of AE curve})$ $\text{Multiplier} = 1 / (1 - 0.45) = 1 / 0.55 = 1.818181812$ 4.

a) Given that the increase in unemployment means a decrease in real GDP, and that consumer spending and investment spending reductions mean a fall in aggregate demand, the economy is in recession.

This is due to a fall in aggregate demand, and the fall in investment may lead to higher costs of production in the future. b) In a recession, the number of people experiencing economic hardship increases, so induced transfer payments such as unemployment benefits and welfare benefits increase. Induced taxes and induced transfer payments decrease the multiplier effect of a change in autonomous expenditure such as investments, and moderate recessions making real GDP more stable. Discretionary fiscal policy would be used in an attempt to restore full employment.

The government might increase its expenditure on goods and services, cut taxes, or do some of both, increasing aggregate demand. An increase in government expenditure or a cut in taxes increases aggregate expenditure

as well. c) In a recession, the Bank of Canada will conduct an open market purchase to lower the interest rate. The quantity of investment will increase, and other interest-sensitive expenditure items will also increase. With an increase in aggregate expenditure, the multiplier increases aggregate demand, bringing real GDP to equal potential GDP, and a recession will be eliminated. . Keynesianism is loosely defined as the economic view that, left to itself, the economy may not fully employ the resources available, and that expansionary governmental action may be required to achieve full employment and growth. Monetarists, in contrast, think broadly that the principal economic task of government is to regulate the money supply, and in particular set limits to it, and that achievement of adequate levels of employment and growth can be left to the market. Historically, Keynesians avoured fiscal policy and monetarists favoured monetary policy as the tool for stabilizing aggregate demand. Today, the divide between the two schools on this issue has almost vanished. Monetarists favour a target growth rate for the quantity of money, and feel that not keeping money growth on target risks outbursts of inflation. Keynesians favour a target for the interest rate, and feel that aggregate demand can be controlled more accurately by preventing the interest rate from fluctuating too wildly, which it might do with strict targeting of the quantity of money and its growth rate.

When real GDP falls below potential GDP, Keynesians feel that taking swift action to stimulate the economy by cutting the interest rate and increasing government expenditures is the most effective road to take. Monetarists feel the best that stabilization policy can do to achieve a high level and growth rate of real GDP is to keep inflation in check. Monetarists favour an inflation

target at a low inflation rate. When the inflation rate rises, monetarists want swift action to slow it regardless of the state of real GDP. 6. a) 1000 tons of breadfruit / 500 tons of fish = 2

The opportunity cost of 1 unit of fish in Kiribati is 2 units of breadfruit. b) 750 tons of breadfruit / 1875 tons of fish = 0.4 The opportunity cost of 1 unit of fish in Tuvalu is 0.4 units of breadfruit. c) Tuvalu has a comparative advantage because it is able to produce fish at a lower opportunity cost than can Kiribati. d) Kiribati will import fish from Tuvalu because Tuvalu has the comparative advantage in the production of fish. 7. The three main arguments for protection and restricting international trade are i. the employment argument ii. the infant-industry argument iii. the dumping argument

The employment argument is that if a country imports cheap foreign goods, local workers lose their jobs and become a drain on the welfare system, spending less, and causing a ripple effect of further job loss. The proposed solution is to ban imports of cheap foreign goods and to protect local jobs, but that proposal is flawed. Free trade does cost some jobs, but it also creates jobs. It brings about global rationalization of labour and allocates resources to their highest valued activities. Local jobs are lost, but jobs are created in the foreign countries that now produce those goods.

The local workers who lost their jobs now have better paying jobs because export industries have expanded and created more jobs than have been destroyed. Another point is that imports create jobs. They create jobs for retailers that sell imported goods and for firms that service those goods.

They also create jobs by creating incomes in the rest of the world, some of which are spent on imports of locally made goods and services. The infant-industry argument for protection is that it is necessary to protect a new industry to enable it to grow into a mature industry that can compete in world markets.

The argument is based on the idea of dynamic comparative advantage, which can arise from learning-by-doing. Learning-by-doing is a powerful engine of productivity growth, and comparative advantage evolves and changes because of on-the-job experience. These facts, however, do not justify protection. The infant-industry argument is only valid if the benefits of learning-by-doing accrue not only to the owners and workers of the firms in the infant industry but also spill over to other industries and parts of the economy.

Dumping occurs when a foreign firm sells its exports at a lower price than the price at which the product is normally sold in the foreign firm's domestic market. A firm that wants to gain global monopoly might use dumping, selling its output in the domestic market at a price that is low enough to drive domestic firms out of business. When the domestic firms are gone, the foreign firm takes advantage of its monopoly and charges a higher price for its products. This practice is the typical justification given for anti-dumping tariffs. There are reasons for resisting the dumping argument for protection.

First, it is virtually impossible to detect dumping. The test for dumping is a weak one because it can be rational for a firm to charge a lower price in markets in which the quantity demanded is highly sensitive to price and a

higher price in a market in which demand is less price-sensitive. Second, it is hard to think of a good that is produced by a natural global monopoly. Even if all the domestic firms in some industry were driven out of business, it would always be possible to find many alternative foreign sources of supply and to buy at prices determined in competitive markets.

Third, if a good or service were a truly global natural monopoly, the best way to deal with it would be by regulation. Such regulation would require international cooperation.

8. a) Exports to the US would decrease due to lower demand because it would cost US importers more to purchase Canadian goods. b) Canadian importers would see a decrease in cost when importing machinery and equipment from US suppliers. c) Cross border shoppers would pay less for goods they purchase in the US.) If the retired Canadians have US dollar bank accounts, the fluctuation of the Canadian dollar would likely have little effect on them. However, if they have Canadian dollar bank accounts or have Canadian currency, they can buy more with those Canadian dollars.

9. Current account Exports of goods and services+411 Imports of goods and services-378 Net transfers+3 Net interest payments-34 Current account balance+2 Capital account Foreign investment into Canada+22 Canadian investment abroad-35 Statistical discrepancy+10 Capital account balance-3 Official settlements account Official settlements account balance-1