Economics

Table of Contents

Decisions by Stakeholders

The key organizational stakeholders will decide in a manner so that any change in rate of interest does not devaluate their investments. When interest rates are declining, the cost of lending rises, that means demand for cars and trucks will decline, hence revenue generation will fall. Stake holders might decide to shift their emphasis on fee based services rather than selling cars. Stakeholders might feel the need to develop robust working capital management techniques so that the liquidity and solubility conditions are met.

Rate of interest and operating cost

Rate of interest directly affects the cost of operation of a business. An organization will have to pay higher interest coverage for their long term debts. In addition to this, the charges for bank overdraft and short term borrowings will rise which will affect the working capital balances adversely. If the company has leased manufacturing instruments, it will have to pay a higher lease rental. Since an increase in the interest rates will tend to squeeze money out of the economy, employees might demand higher salaries as well.

Interpretation of yield curve

The current yield curve is as follows:

Source: Bloomberg. com

According to Bloomberg, the yield curve (as on May 8, 2009) predicts the rise of interest rate in near future. This means that organization will plan to maintain its profit in future. It can provide discounts to enhance the sales volume to make reserves for the dry season ahead. It can restrict research and development activities and curtail unnecessary costs since revenue generation might see a downfall.

Rate of interest and customer demand

Cars and trucks are costly commodities and are generally bought by customers if they get convenient borrowing schemes. This makes interest rates a decisive factor in determining the sales. A high interest rate means that customers will have to pay a higher installment (EMI). This has greater implications for earning assets like trucks; customers (generally transporters) will postpone their present demand in anticipation of lower interest rates in future. This translates to the fact that consumer demand for both cars and trucks will come down.

Monetary items affecting costs

The main monetary items that affect the operations of a business are the cost of goods sold and general and administrative expenses. Cost of goods sold will depend on the cost of raw materials and the wages of the employees. The company might have to incur advertising and selling costs as well. For purpose of accounting, the company will have to incur depreciation expenses. The tax structure of the country where the company operates is an important determinant of operating costs. A high tax bill will increase the financial obligations and reduce the profit figures.

Money creation by banks

A bank is an institute that accepts deposit and lends money to its customers.

The bank charges an interest from the borrowers and provides interest to the depositors. When a bank accepts deposit, it keeps a fixed percentage as reserve and lends the remaining amount. The amount lent again gets deposited in some other bank where a similar proportion is kept as reserve and the remaining is paid as loan. This cycle creates money by the proportion in which money is lent out. The sum total deposits will be actually found to be more than the initial deposit. This is the method that banks use to create money.

Reference

Yield Curve of Government Bonds, (8 May 2009), Bloomberg, Retrieved, May 8 2009 from http://www. bloomberg. com/markets/rates/index. html,