5b: report

Eric Brockett, BankZero Regional Manager [Click here and type , Assistant Manager Fed Announcement Instructions For this assignment you will write a 300- to 500-word report to Eric Brockett evaluating the pending Fed changes. Your report should do the following:

Explain the economic impact of the change in the reserve requirement. How will the money supply be affected by this change?

Explain the economic impact of the change in the discount rate. How will the money supply be affected by this change?

Describe how the Feds announcement will affect the banks required reserves.

Explain the banks options for responding to the Feds announcement, and briefly describe the advantages and disadvantages associated with each option.

Be sure to

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Type answer here

Economic Impact of changes in reserves requirement

There are various way through which central bank can alter the money supply to achieve its monetary policy targets. One such tool is the change in the reserve requirements for the banks. Under statutory regulations, every bank is supposed to deposit some percentage, as described by the central bank, of their deposits with the central bank. Central bank therefore in order to increase or decrease the money supply can increase or decrease the reserve requirement. By reducing the reserve requirement, central bank basically increase the loanable funds in the economy thus increasing the money supply to create growth through monetary expansion. The higher money supply will put pressures on the interest to go down as increase in the money supply causes the equilibrium rate of interest to fall thus providing sort of easy money to individuals to borrow however on the same hand increased money supply can increase inflation in the economy too. Similarly increase in reserve requirements will have opposite impact on the economy.

Economic Impact of changes in Discount rates

Changes in discount rates are considered as one of the highly sensitivity measures taken by the Central Bank to alter the money supply in the economy. Assuming other things constant, a change in the discount rates like increase in discount rates will increase the interest rates in the economy. With the increase in interest rates, firms and individuals will find themselves hard to borrow money at cheaper rates. Once interest rates go up the demand for money decreases internally however from the external business environment perspective, the demand for money will increase because the foreign investors will it lucrative to invest into the economy because it is offering higher interest rates especially on short term investments. The immediate economic impact of the change in the discount rate will be increase in the interest rates. This increase in interest rates will result in the increase for the borrowing costs of the firms hence their profitability and revenue. This reduction in revenue and profitability will in return decrease the GDP of the economy.

Options for Bank

There are 2 actions which are being anticipated by the Bank that FED will be taking. One is the increase in the reserve requirements and then there is also rumors of 2% increase in discount rates. In this scenario, the only viable option for bank will be to sell its long term investments. Since interest rates are going to rise therefore the market price of these investments will decrease therefore it will be better if we sell of these investments now and convert them into cash so that we can place them on high interest rates. The most important advantage for this action would be that the Bank will be able to save depreciation in its investment due to increase in interest rates in the future however a disadvantage would be that the Bank will be loosing some of its strategically placed investments.