

Monetary control

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Monetary Control work Question Banks create money through loans and buying of assets. When a bank loans out money to individuals, they sign a contract that shows the period the customer has to repay the loan. For example, when a customer is to repay the loan in a period of five years, it means the signed contract represents a future income stream for the bank. When the bank draws up its financial balance sheet, the loan given will be included in the assets column as an additional asset. Banks also make money from acquiring and buying of assets. The assets the bank decides to buy can either be real assets, for example, buildings or financial assets such as bonds. It is very interesting to note that a bank loses money when a loan is repaid. The currency is destroyed and disappears from the economy entirely.

Question 2

Open Market Operations are one of the primary tools that the Federal Reserve employs to accomplish its monetary policy objectives (Axilrod, n. d.). They entail the acquiring and selling of government securities. The Federal Reserve has no power to choose whom it engages in business activities. The primary dealers operate on a price basis to gain access to the open market operations. Open Market Operations facilitate the Federal Reserve to influence the supply the reserve balances in the banking system. The effect is on short-term interest rates to spread to other monetary policy targets (Axilrod, n. d.). Open Market Operations allow central banks the flexibility to manage the volume of financial operations on their initiative. The domestic trading desk of the Federal Bank of New York under the supervision of the Federal Open Market Committee conducts open market

transactions (Axilrod, n. d.). The federal funds rate does respond to changes in demand for and supply of the reserves in the banking system. It, therefore, shows a good sign of the existence of credit in an economy.

Reference

Axilrod, S. (n. d.). Economic Issues No. 5--Transformations to Open Market Operations. Retrieved May 28, 2015, from <http://www.imf.org/external/pubs/ft/issues5/>