Complexities of the us financial system essay

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The US financial markets impact the economy, businesses, and individuals in a variety of ways, one of which is providing a way for businesses to raise capital by issuing securities. The capital markets enable new companies to raise funds to grow. Typically, banks would not lend in these situations because of the lack of sufficient collateral and high risk. Without the public securities markets or private venture capitalists to provide the funding for these higher risk investments, the economy would be much smaller.

The markets and the economy are closely linked and are especially reactionary to the each other, i. e. if the economic indicators show recession, the markets typically turn down, particularly the equity markets. Currency markets, FOREX or foreign-exchange markets, and the mortgage markets will move in response to the health of the economy and the movement of interest rates. Should those economic indicators prove to be positive, then the markets turn upwards or even " fly".

When the markets experience an intense downtown, it can lead to a severe recession with the prices of financial assets declining sharply, which can cause individuals, businesses, and financial institutions to become less able to handle their debt payments or it can even lead to financial system failure with widespread bank closures and mortgage foreclosures in extreme cases such as the 2008-09 crisis, when the U. S. Government and the Fed were required to step in and take action to prevent total system failure.

The U. S. economy still hasn't fully recovered. The U. S. Federal Reserve Is a Central Bank of the U. S. and is responsible for monetary policy and regulating the banking system. The Federal Reserve System consists of

member banks, Federal Reserve District banks, the Board of Governors, the Federal Open Market Committee, and advisory committees.

The Federal Reserve Act requires all member banks to purchase capital stock of the Reserve Bank, which means member banks on the reserve. There are 12 Federal Reserve districts each of the Federal Reserve District Bank. The Federal Reserve Bank’s responsibilities include: holding reserve balances for depository institutions and lending to them at the discount window, propose discount rates, furnish currency, collect and clear checks and transfer funds for depository institutions, handle U. S. government debt and cash balances.

The Board of Governors consists of seven appointed members whose responsibilities are setting the reserve requirements and improving discount rates as part of monetary policy, supervise and regulate member banks and bank holding companies, establish and administer protective regulations and consumer finance and oversee the Federal Reserve Banks. The Board of Governors is advised by the Consumer Advisory Council, the Federal Advisory Council, and the Thrift Institutions Advisory Council.

The Federal Open Market Committee, which consists of the Board of Governors and five Reserve Bank presidents, directors open-market operations-the Fed’s primary instrument of monetary policy. The Federal Reserve chairman, currently Ben Bernanke, is generally recognized as both the most powerful influence on monetary policy in the nation and one of the most formidable and influential global financial positions. The Fed’s policy of the past four years has only been partially effective.

As the only central bank was a dual mandate, to control inflation and encourage employment, the Fed has two tools with which to accomplish this: setting interest rates and open-market purchase/sale of securities. The Fed has lowered interest rates for banks to borrow money but pays the same banks a higher rate of interest on their deposits at the Federal Reserve, enabling those banks to earn a riskless return on their borrowings. This helps bolster their balance sheet but discourages them from taking risks such as making loans.

This is why there hasn't been any inflation from monetary creation through the money multiplier and why the lack of credit availability has contributed to the slow growth of the economy. Similarly, while the Fed has pumped trillions of dollars into the financial system, little of it has actually found its way into the real economy to help stimulate demand, hence job creation remains subpar. Other central banks are struggling with the same issues.

One approach being considered by the European Central Bank is to charge interest on funds left on deposit with them to encourage banks to lend. Bernanke has mentioned this is one option open to the Fed in the future. Interest rates influence the U. S. and global financial environment by affecting the value of a country's currency. Raising interest rates attracts foreign money seeking higher yields, which increases demand for the country's currency, forcing it higher in value.

This is why some countries cut interest rates to stimulate their economy by making their goods and services cheaper for foreign buyers. The Bank of Japan's newly enacted quantitative easing is an example of a central bank

trying to drive down the value of its currency in an attempt to end deflation but also benefiting exporters by giving them a trading advantage through a depreciated currency. “ Through its third round of quantitative easing, the Federal Reserve is essentially printing $85. 0 billion a month in new money and buying government bonds and mortgage-backed securities with the newly printed money.

The Bank of Japan has been taking similar measures for some time now and is failing to move the Japanese economy toward growth. In spite of its failure, the Bank of Japan has taken quantitative easing to another level. The central bank announced it will inject $1. 4 trillion into the Japanese economy in its attempt to end the deflation and economic misery the country has been experiencing for years.

The Japanese economy is in a recession, and the country’s exports are in a slump. If as a result of its quantitative easing, there are fears that asset bubbles are forming in the Japanese economy. The Japanese yen has fallen in value by more than 30%, as is shown on the adjacent chart. Key stock indices in the Japanese economy have increased substantially and are reaching beyond the highs made in 2008. In the U. S. economy, we see the same thing happening.

Quantitative easing is creating inflationary pressures, bond investors have been squeezed and are forced to take higher risks, and the stock market is moving ahead of reality. “- From China is a perfect example of currency manipulation, although China has taken it to an extreme, bordering on

violating international financial law by forcing their currency to remain undervalued.

Market forces should be raising the value of the Yuan given where interest rates and money flows would indicate, which would make China’s exports less competitive. To prevent this, China has pegged the exchange rate for its currency to that of the United States, its biggest trading partner. By doing so, it keeps the Yuan artificially depressed, thereby preventing it from appreciating and giving the Chinese an unfair advantage.

In addition to the previously discussed factors, a change in exchange rates can affect a business competing globally in many way such as by changing the price of imported raw materials, the price of competitor’s products may change in the home market, or increase or lower the price of a product sold abroad. For example, an increase in the exchange rate will mean that price abroad goes up, lowering sales; the price of imported raw materials falls, either leading to a fall in price in more sales, or increase in profit; competitors’ prices fall, meaning lower sales.