Montery policy

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Your Monitory Policy and Recession Monetary policy is the process by which a government, the central bank, or the monetary ity manages (i. e., either increases or decreases) the supply of total money in the economy, or trading in foreign exchange markets. When the supply is increased it is called the ‘ expansionary policy’ and when it is decreased it is called ‘ contractionary policy’ [1]. Monetary policy should be contrasted with fiscal policy, which refers to government borrowing, spending and taxation.

Recession is a period of general economic decline; specifically, a decline in the gross domestic product (GDP) for two or more consecutive quarters [2].

Monetary expansionary policy is traditionally used to combat unemployment during recession, by lowering interest rates and increase in the total money supply. This is done with a view to increase consumer spending, creating demand for goods and services. However, if checks and balances are not kept in place, increased money supply with inadequate increase in supply of goods and services may lead to inflation, which in turn may accentuate demand contraction and therefore, recession!

Mackay and Evans article, ‘ Recession fears weigh heavily on the markets’ (WSJ, Nov 26, 2007) deals with the situation of the US economy in the background of mounting worries of market players about the sluggish economic growth and sub-prime crisis in the housing and mortgage markets. The 8. 4% drop in the Dow Jones Industrial Average index, during the third week of November 2007 from its all time high and increased interest in the bond market are pointers to the market worries. The Federal officials do not share this gloomy prediction and expect the economy to clock 1. 8 to 2. 5% growth in

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the next year and that the sub-prime crisis should bottom out soon. This view is also supported by the Commerce Department, which is revising the Jul. – Sept. 07 GDP growth to 4% and confirming positive income and job growths. J. P. Morgan on the other hand, predicts a much lower growth rate of 1. 5% in the first three quarters of 2008. Both

predictions do not amount to a period of recession – rather a slowdown only. The article points out to the delicate balance in the various sectors of the economy which could be upset, if institutions reduce lending to the housing sector and if this is coupled with reduction in spending by consumers on gasoline due to rising fuel prices. A slump in consumer spending is bad for the US economy as well as for the economies around the world, which export their products to the large US market. The contagious effect of the US housing crisis to the European markets is already being felt with inter-banking rates firming up and funds drying up.

Call it recession or a slowdown, the reduced consumer confidence is having an impact on some sectors of the economy, like automakers, financial sector and home makers. Of late, share prices of companies in these sectors have sharply declined. Surprisingly, even the revenue earnings of companies dealing in luxury goods are declining, which are normally insulated from recessionary trends.

The redeeming feature of this otherwise gloomy picture is the surge in US exports supported by a weak dollar and strong demand from the Asian, Latin American, Middle East and Emerging Markets.

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