Example of essay on economic volatility

Business, Marketing

In recent times, economic volatility in asset prices has become the norm rather than an exception. While the reasons for this are varied including better data access to monetary and political changes, fast flow of information globally and better money flow system for the global investor, we seek to explore the effects of monetary policy on asset prices (stocks, currencies and commodities).

We refer to the article written by Weber. From past experience of monetary policy changes and corresponding data (Magnus 123), I would certainly agree with the basic fact that monetary policy brings economic volatility. As far as Weber's argument goes, he expects a higher level of volatility than normal due to diverging monetary policy changes in two of the world's largest economies. If monetary policies in two large economies go in the opposite direction, asset prices will fluctuate in unpredictable ways not only in both these regions, but also globally. So in principle, I would agree with Weber on his view of the effects of monetary policy divergence effects of these two regions on asset prices.

The US Fed or any central bank increases interest rates only when it observes signs of expansion in the national economy. As it stands, the US currently is seeing some green shoots, but no green signals on the structural side, and I would not think the US in the midterm would think of increasing interest rates, thereby risking asset volatility both in the US as well as abroad. The IMF also seemed to reflect the same view by cutting growth forecast for the US. (Rastello, Glinksi).

We now proceed to examine the effects of interest rate changes on asset volatility by consider a scenario where interest rates rise in the US. The

effect of such a rise may not be immediate but it results in a higher cost of borrowing for companies resulting in a dip in capital expenditures. The market views this as negative since it impacts future cash flows of the company and accordingly price falls. The sum effect then contributes to the fall in the market index. On the other hand, currency markets typically rise with a rising interest rate since traders usually prefer buying and trading currencies that have higher interest rates. Commodity markets usually fall as interest rates rise and markets can turn highly volatile since not all underlying commodities in an exchange react the same way.

Similarly, if we examine a scenario where interest rates fall in Europe, we will see stock markets boom upward since cost of capital for companies fall. However, currency markets may see a dip since a falling currency impacts confidence of currency traders and such traders would usually shift to alternate currencies such as the US Dollar which has a rising interest rate as explained above. Likewise commodity prices would usually rise as well, barring a few commodities that might be not be impacted as much.

It should be further noted that asset price volatility is stronger in the United States than Europe. (Magnus 128) Based on above, one can imagine how asset prices will go very volatile in the short term in response to two such divergent events. Such events usually then tend to have a ripple wave effect globally. Weber’s contention that volatility would spike due to these policy divergences stands true. Further given the fact that markets have risen without changing economic fundamentals on the ground are also a reason to worry since a market fall will be disastrous.

In conclusion, I agree with Weber not only because past data supports his

views, but also because assets behave structurally in the manner indicated above. At this point, the divergent steps taken by both central banks can bring short term volatility that would affect all asset markets in some way. Since our world today is connected and investors have gone global the volatility of this event will not be confined to just two markets but will be all over the world.

Works Cited

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