

The rate of interest

Finance



An increase in the purchasing by the central bank in the security market increases the amount of money that people has and it increases the money supply in the economy. Similarly, selling these securities in the money market dampens the people buying power and reduces the money supply in the economy.

1c) Funding: This option is probably the most effective of the lotto change the money supply in the economy. By funding, we mean that the central bank changes the composition of the national debt in order to alter the money supply in the economy. When it wants to reduce the money supply in the economy it issues more illiquid assets to fund the national debt like long-term securities. Similarly, when it wants to increase the money supply in the economy it funds the national debt by issuing liquid assets, such as treasury bills.

4A) During the last year (2008), we witnessed a severe recession. In order to lubricate the economy towards growth, many governments decided to reduce the interest rates in order to increase the aggregate demand and lead the economy towards growth. The graph in this site shows, how rapidly interest rates were decreased in Australia following this recession.

(<http://www.news.com.au/money/interest-rates>)

The government of the USA conducted a more open market.

r recession, the U. S government is trying to increase the money supply in the economy by funding a major chunk of its debt with treasury bills which are liquid assets.

(<http://home.att.net/mwhodges/debt.htm>)

The government of the USA conducted more open market operations than ever before in 2008. During this period they bought more securities than

<https://assignbuster.com/the-rate-of-interest/>

they sold. This increased the money supply in the economy and reduced the impact of the recession. (<http://www.zerohedge.com/article/open-market-operations-and-statistics>)

4B) The best strategy for me to control the money supply in the economy will be Funding. Funding is twice as effective as open market operations as it reduces the overall money supply in the economy and not just of the commercial banks. This method has a very satisfying result for the government all over the world as it saturates money completely from the economic pipeline. The only disadvantage of this method is that it cannot be used as a tool for short-term strategy. If for example, after a small period of time, the government decides to increase the money supply, it won't be able to do so, because long-term securities had already been issued.