Macro economics critique essay

Economics

As early as 2006, contraction in the housing market was already felt. “ The Federal Reserve has responded to the unfolding situation by acting to improve the access of depository institutions to liquidity and by easing the stance of monetary policy substantially” (Kohn, 2008). Discount rate is “ the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank's lending facility--the discount window” (Federal Reserve Board, 2007).

Even though the policy seem to worsen the gradual rise in inflation, because a decrease in discount rate increasesmoneysupply, the Federal reserved choose to ease out the banks discount rate to ease out lending for mortgages in the housing market. This is because the observed increase in the prices of energy, foodand other basic commodities, are largely affected by growing demand in the rapidly growing economies like China that provides best-cost for many segments of the market.

Although this is more of a contradictory monetary policy, because it increases money supply to reduce the demand in the housing market, yet it does not fall to the extent of its full meaning. Money supply is “ the total of cash in circulation and deposit liabilities of banks and thrifts” (Hummel, 2005).

2. Inflation has traditionally been a concern of the Federal Reserve. Recently, there has been the possibility of deflation. Should the Fed be concerned with deflation of prices?

The tightening in the housing market is a sign that there is a possibility of deflation. The selling price dropped due to the lower demand. This is because " investors became concerned about the likely performance of many subprime adjustable-rate mortgages made from late 2005 through early 2007" (Kohn, 2008). Traditionally only inflation was perceived to be a problem but deflation has been associated with economicdepressiontherefore Fed should be concern.

4. Can deflation occur without recession? Will deflation worsen a recession or shorten it? Explain. Should the Federal Reserve do anything to prevent deflation? What policies do you recommend the Fed follow?

Yes, if the deflation is not affecting the total investment or output in the areas of goods or commodities where it is observed. In most cases deflation and recession always come together because as the prices of goods or commodities drop like in the case of the housing market, the demand of that commodity and thus total investment on that area also drops. Deflation worsens recession because as the prices of these goods, energy or commodity drops, as said before, the investment on that area drops and gross domestic product will be affected. The monetary policy being used recently to address the constriction the housing market is a good decision for the Fed.

5. Is inflation still a possible threat? What could cause a rise in inflation? Suggest some possible scenarios.

Inflation is still a threat. As mentioned earlier the current inflation in goods, energy and basic commodities is affected by the rapid growth of best-cost countries like China and India. Although inflation is also affected by the increase in the cost petrol based energy sources and many twists in the recent economic status but the greatest contribution is still the growing demand for best-cost countries like China and India. When the demand of a good or service in a best-cost country increases, the price of that good or service consequently increases. Since we import these goods from best-cost countries because it is too expensive to produce locally, the price of that good or service here in the US increases. This causes inflation.

References

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