Brazilian interest rates assignment

Business

In order to stimulate their economy, Brazil decided to opt for expansionary monetary policy by cutting interest attest in hope of boosting the economy. To assess how this will work in Brazil, it is necessary to analyze the pros and cons of monetary policy along with considering other options. Interest rates are being cut due to the continuing slowdown in the global economy which makes it necessary to analyze how decreasing interest rates will help the economy. A cut in interest rates will cause the demand for money to increase which will in turn cause the supply of money in the economy to rise.

Additionally, investment will increase because of the shift in money supply and increase along the none demand curve because it is now easier for consumers to borrow money. Finally, and perhaps most importantly, the aggregate demand will shift out due to the decrease in interest rates, which causes an increase in consumer spending, both determinants of aggregate demand. The shift of aggregate demand will then ideally eliminate the recessionary gap experienced because of the recent decreased demand due to the slowdown in the economy.

Other than monetary policy, Brazil can also consider fiscal policy by getting the government involved in setting the supply of money. The government can do this in one of two ways, reducing taxes, or increasing government spending. Lowering taxes would in essence increase consumer spending because less money would be taken away from consumers, giving them more money to spend. Additionally, government spending is a determinant of aggregate demand so an increase in government spending such as on projects to improve capital in the country will lead to a shift of the aggregate demand curve.

However, even though on paper the central banks decision to lower interest rates seems ideal, there are problems associated with this decision. First of all, Brazier’s central bank is assuming that consumers have confidence in the economy when this may not be the case. A lack of consumer confidence will cause consumers to save their money instead of invest it causing a leakage in the circular flow model and thus failing to inject life into the economy. Secondly, the primary concern is inflation.

Although the price level is increasing as a result of money supply shifting, the value in money is decreasing because each unit of money is not as valuable due to a larger amount of money in the economy. It is a good sign to see that the central bank has lowered reserve requirements, the minimum amount of money required for a bank to hold, to discourage spending as this may offset some of the inflation. Despite this though, if inflation continues to rise, the aggregate demand curve may also shift past the equilibrium, causing an inflationary gap.

With inflation already relatively high, an increasing inflation rate could provide grave consequences for Brazil in the future. In conclusion, Brazil has decided to use expansionary monetary policy in order to stimulate the economy in this recent downturn. The decrease in interest rates will cause money supply, investment, and aggregate demand to increase in the economy. However, the main drawback of this method is the dangerous cost of inflation which is already a concern for some in Brazil.

Reuters Article: UPDATE 2-Brazil raises key interest rate to two-year high wed Par 2, 2014 7: PRNG EDT By Alonso Sotto (Reuters) – Brazil raised interest rates for the ninth straight time on Wednesday, prolonging one of the world's longest-running monetary tightening cycles after a surge in food prices stoked already high inflation in an election year. The unanimous decision by the central bank's monetary policy committee raised its benchmark Sells rate by 25 basis points to 11 percent, its highest level in over two years.

All of the 62 analysts surveyed by Reuters predicted the hike. The bank changed the language used in its decision statement to say that the bank's next monetary move would hinge on how the Brazilian economy as a whole evolved. " The committee will monitor the evolution of the macroeconomic outlook until its next meeting, to then define the next steps in its monetary policy strategy," the bank said. In the statement, the bank moved a previous reference to continuation of the adjustment cycle and instead added that it decided to hike the rate at " at this moment. Although another rate hike in May has not been ruled out, the statement signaled that the bank would be very sensitive to upcoming economic and inflation indicators to decide whether to continue raising borrowing costs or end the cycle. Many analysts have said the bank could very well end the tightening cycle in May to avoid hampering the growth of an economy that has been stuck in a rut for the last three years. The central bank will eve to find the right balance that allows it to ease inflation and avoid further slowing growth as President Dilemma Rousseau prepares to run for re-election in October.