

Complexities of the u.s. financial system

Finance



U. S Financial System U. S FINANCIAL SYSTEM Question Describe how the U. S. financial markets impact the economy, businesses, and individuals. The U. S financial market involves financial transactions that include but not limited to bonds and stocks. These transactions ensure money changes hands in the economy as well as growth of enterprises. Component of the U. S financial market include the Dow Jones industrial average, transportation average and the utilities average among others. Stocks are traded in the stock exchange e. g. the New York stock exchange and the NASDAQ. The US financial market impacts directly on the economy in that a commodity such as gold is traded in the markets and used to cushion the economy against the negative impacts of inflation (Edwards & Garcia, 2008). According to Meltzer (2009), the financial market impacts directly on business through for example interest rates that among other factors determine the cost capital for businesses. On an individual basis, the capital market impacts individuals in their day to day lives through numerous ways including pension's funds that have been proven to have a positive correlation to equity prices (Mishkin& Eakins, 2009). Question 2: Explain the role of the U. S. Federal Reserve, the Federal Reserve Chairman, and Board, indicating its effectiveness in today's economic environment. Provide support for rationale. The Federal Reserve plays the role of executing monetary policies such as stabilizing prices of commodities as well as creating maximum employment opportunities. Being the central US banking system (Meltzer, 2009) it comprises of a chairman and a board, both appointed by the president. The chairman as the head of the Federal system and provides leadership to the board. The mandate of the board is to analyze international financial development as well as regulating federal banks in the US. The effectiveness of the federal bank in <https://assignbuster.com/complexities-of-the-us-financial-system/>

executing its mandate is based on its independence from the executive arm of the government. Under the banking Act of 1935 the Federal Reserve executes its mandate and reports only twice a year to the Congress. Though independent, the Federal Reserve has a duty to perform its obligations in tandem with the overall financial objective of the government (Meltzer, 2009). This ensures that it remains effective in today's economic

environment. Question 3: Explain how interest rates influence the U. S. and global financial environment. Provide support for explanation. As part of its mandate, the Federal Reserve monitors interest rates in the economy.

Interest rates are determinants of prices of goods, cost of capital as well as the level of inflation. According to Meltzer (2009) low levels of interest rate enables people borrow more funds for spending. Low interest rates increase consumer buying power at the same influencing positively on public spending. When interest rates are low, consumers will see that the cost of funds is low and will borrow funds. This added to their incomes leaves them with additional money to spend (Edwards & Garcia, 2008). Demand for goods such as furniture, houses and cars increase as individuals want to spend their money on commodities that they need. Globally, interest rates impact on prices of commodities such as minerals like gold, diamonds and oil as well as prices for agricultural products, especially so for export products. Interest rates and inflation rates in the US are often different from those in the export market. According to Meltzer, (2009) interest rates are relatively low in the developed world, US included, an effort aimed at increasing borrowing by consumers and minimizing saving. By having low interest rates, individuals borrow more and thus spend more. Meltzer, (2009) argues that stock markets become more effective in creating wealth for stock holders if

interest rates remain as low as possible, near zero if possible. Question 4: Describe how exchange rates may impact a business's decision to operate in foreign markets Exchange rates will vary and impact on the decision of operating in foreign markets for a firm. Fluctuation on exchange rates will impact on the day to day operation of the business, cost of raw materials and finally on the pricing of the final product. When a business decides to operate in foreign markets, foreign exchange rates will impact level of profitability of the firm. Fluctuations on exchange rates may reduce profits or lead to additional gains in the form of foreign exchange gain, impacting positively on the balance sheets for profits not related in any way to business activity. Mishkin & Eakins (2009) argue that exchange rates affect demand and supply dynamics for an enterprises product in foreign markets. Interest rates will determine the cost of capital in the foreign markets while inflation rates will affect the pricing policy on the products for firms operating in foreign markets. In conclusion, for a business moving into a foreign market, the owners must take into consideration what impact interest rates pose to their business. References Edwards, S., & Garcia, M. G. (2008). Financial markets volatility and performance in emerging markets. Chicago: University of Chicago Press Meltzer, A. H. (20032009). A history of the Federal Reserve. Chicago: University of Chicago Press. Mishkin, F. S., & Eakins, S. G. (2009). Financial markets and institutions (6th ed.). Boston: Pearson Prentice Hall.