

# [Business investors](https://assignbuster.com/business-investors/)

ASSIGNMENT Monetary Policy to Sustain Economic Growth: The goal of monetary policy is to help economy achieve price stability, full employmentand economic growth. Federal Bank is responsible for developing a “ monetary policy” which consists of open-market operations, the reserves ratio, and the discount rate. First, Open-market purchase operations are used to increase money supply because Fed purchases securities and bonds from public and banks, and in turn, provide cash or money. Similarly, open-market sale operations are conducted to reduce circulation of money in market through sale of securities, bonds etc to governments, general public etc. The aim is actually to create a balance of money in circulation i-e bringing money supply and demand in equilibrium to accomplish business growth and economic stability. Secondly, Fed changes the Reserve ratio which means the percentage of commercial bank deposit liabilities required as reserves. And third is the change of discount rate which is the interest rate the Fed charges on loans to banks and thrifts. (McConnell and Brue, 2002)
The term Business cycle refers to alternating rises and declines in the level of business activity. Both unemployment and inflation are associated with business cycles.
Fed uses a “ tight monetary policy” when an economy observes inflation (increasing trend in prices). Here I assume that it is a demand-pull inflation which means that Aggregate demand is excessive relative to the economy’s full employment level of real output. It is actually the spending that has resulted in inflation. Fed then reduces the money supply by open-market purchases, increase the reserves ration and the discount rates. Banks will in turn stop issuing new loans as old loans are paid back. Higher interest rate discourages investment, reduce aggregate demand and refrain this inflationary trend.

A typical business cycle has four stages which include peak, recession, trough and economic recovery. A “ Peak” is observed when the economy reaches a temporary maximum point. Here, the economy is at full employment level and the output is at or very closer to economy’s capacity. Then, the peak is followed by an economic decline called as “ Recession”. The total output produced, trade, prices, employment and income generated by an economy contracts and it observes a negative growth. The next stage is known as “ Trough” where output and employment reaches a “ temporary minimum”. The Fed in order to cope with this situation introduces an “ easy monetary policy” which aims to increase money supply by pumping more money in the economy, lower reserves ration and discount rates. Investment is encouraged because of reduction in interest rates, aggregate demand increases and economy recovers. The final stage of business cycle is “ recovery” in which output and employment rise towards full employment. It must be highlighted that an economy will not have a single permanent peak and stability point neither a permanent trough rather it observes declines due to various external factors and later the economic recoveries because of changes in monetary policy.
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Sources:
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