Monetary and interest rates

Economics, Money

Economics remains a very complex subject. This is particularly true when the subject of interest rates is concerned. That is why a clear examination of the subject of the economy, monetary rates, and interests is needed. Such an examination will provide a clearer perspective on how the mechanism of the economy functions. Without a doubt, the major economic indicators I would look at when seeking to make a large purchase and apply for a loan would be my cash flow and the interest rate of the loan. In terms of cash flow, it would be critical that I was purchasing something that I could afford.

Yes, it would be possible to acquire a loan based on my credit rating and personal financial situation. However, the ability to pay back the loan in question is important. When a person is buried under a mountain of debt, the ability to maintain any individual freedom is limited. Of course, there are also the economic problems associated with excess debt that one must take into consideration as well. Also, interest rates much be examined carefully prior to taking out a loan. On the surface, it would appear that the difference between a 7% interest rate and an 8% interest rate is very minimal.

However, the difference between the two is enormous. Mainly, this is because that one percent can lead to significant amounts of additionalmoneythat must be paid back over time. For example, a 1% difference of the life of a mortgage loan could yield paying $50, 000 more dollars than one would have paid with a lower rate. Yes, one single, solitary percentage point can yield an additional payment of over $50, 000! Often, it is a Monetary and Interest Rates -2 lack of understanding of the “ power” of an interest rate over time that leads people to make poor borrowing decisions.

That is also why they find themselves unable to get out of massive amounts of debt. To avoid such problems, understanding your cash flow limitations and the severity of interest rates is critical to financial success. The Federal Reserve Board plays an integral role as far as interest rates are concerned. Specifically, it is with the Federal Reserves power to raise or lower interest rates. Often, when the economy is in very bad shape, the Federal Reserve will make the decision to lower interest rates. The hope here is that the extra cash people will have in their pocket will be spent.

That is, it will return to the economy where it will have a net positive effect. Of course, there are other factors at work that can make an economy perform positively or negatively; but, “ playing” with interest rates can often have a very positive effect on the overall economy. In a way, this would be indicative of the expansionary and contractionary policies of the Reserve. Specifically, an expansionary policy is one that seeks to add more money into the economy and a contractionary policy is one that will lead to reduction in the amount of money in an economy.

Again, lowering interest rates would be an example of an expansionary policy while raising interest rates would be an example of contractionary policies. But, why would any nation wish to employ a contractionary policy? When the domestic monetary supply is low, the value of the currency may increase. This would make investors less likely to look into foreign currency investment options. As such, Monetary and Interest Rates – Page 3 significantly more investment dollars might flow into the United States. Clearly, this can be a risky proposition and that is why you here so little of these types of policies being enacted.

They are not exactly popular with the public at large. Since we do not live in a bubble, the decisions made by the Financial Reserve will affect all of us. That means it is critical to pay attention to statements and policies made by the Federal Reserve. For example, if the Reserve makes decisions to raise or lower interest rates then one needs to adjust lending and purchasing practices as a result. Personally, I would take the decisions very seriously if I were to make a large purchase that required financing. For example, if interest rates were cut I would look into options available to acquire a mortgage.

Returning to our previous example of how one interest rate point can dramatically affect the life of a loan, a low interest rate acquisition of a mortgage could lead to getting a home at an apparently huge discount. Conversely, an increase in a percentage point could seriously dissuade me from taking out a mortgage. Why? Because paying an additional $50, 000 on a home vs. receiving a $50, 000 “ discount” on the mortgage is incomparable. It simply would not make a thread of sense to acquire financing at rates that are not beneficial and conducive.

Keep in mind, the money that is saved could be put to work for much better use. That is, the $50, 000 not spent on interest could be invested into the stock market instead. This would then dramatically aid in increasing my personal net worth and wealth. That Monetary and Interest Rates – Page 4 would be much better than paying a bank an inflated interest rate. Yet, others make this mistake largely due to not understanding the consequences of the Federal Reserve’s actions. Thankfully, this is a mistake I will not make as I pay strict attention to situations involving interest rates and payments

To a certain extent, Ben Bernanke has been a decent Chairman of the Federal Reserve. To his credit, he aided in slashing interest rates which has mildly helped a troubled economy. In a way, it is difficult to truly assess Bernanke's performance because he is currently holding his job during one of the worst recessions in American history. As such, there is only so much he can do. He can only stimulate the economy to a limited degree. That is to say, he cannot single-handedly reverse the trends of the recession even though this is the expectation of some people.

Could there be any " tips" provided to aid Bernanke's management of our central bank? Well, if Bernanke would cease making personal and public appearances this would be a major step in the right direction. That is, Bernanke's appearances on television generally have a negative effect on the public's perception of the economy. Why is this? Again, many people are looking for a magic bullet that will eradicate the ills of the economy. Such a magic bullet does not exist. Hence, Bernanke's appearances on television do little to stimulate a decent public response.

However, his decisions to cut interest rates have definitely been helpful. Bernanke truly acted decisively when it came time to cut rates. For that, he showed be applauded for hisleadership. Bibliography Economic Focus, " What goes around. " The Economist 09 June 2007 14 Feb 2009 . Woodruff, Tom. " A borrowers guide to forecasting interest rates. " MSN MONEY 2008 14 Feb 2009 .