PUNJAB UNIVERSITY COLLEGE OF INFORMATION TECHNOLOGY

INTRODUCTION TO ECONOMICS

FIZZA AFTAB

Reference Book : Economics by Paul A. Samuelson

Monetary Policy

FUNCTIONS AND OBJECTIVES OF CENTRAL BANK

- Secure stability in the internal and external value of the currency
- Promote economic growth
- Achieve full employment
- Safeguard gold reserves of the country
- Issue notes and coins
- Acts as the government bank
- Performs as a lender of last resort
- Implement monetary policy

Monetary Policy Instrument

OPEN MARKET OPERATION

CHANGES IN RESERVE RATIO

BANK RATE POLICY

OPEN MARKET OPERATION

Open market operations refer to sale and purchase of securities in the money market by the central bank.

When prices are rising and there is need to control them, the central bank sells securities.

When recessionary forces start in the economy, the central bank buys securities. The reserves of commercial banks are raised. They lend more.

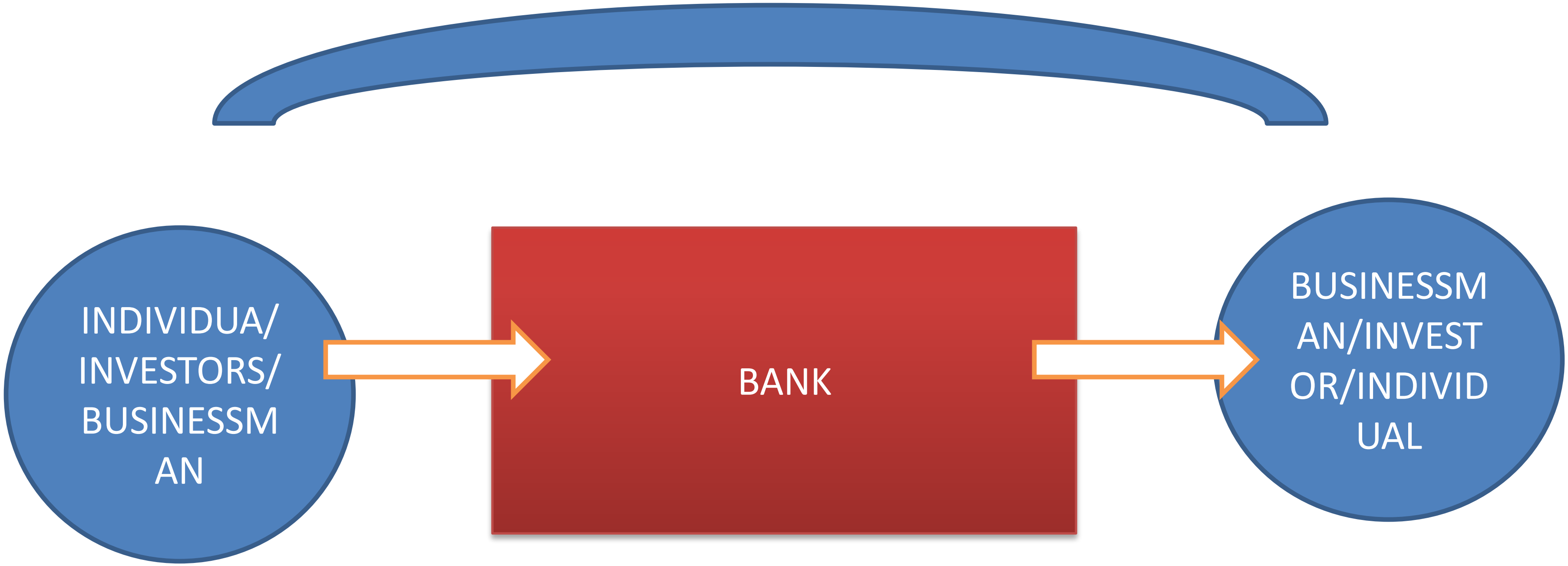
T-BILLS

CHANGES IN RESERVE RATIO

Every bank is required by law to keep a certain percentage of its total deposits in the form of a reserve fund in its vaults and also a certain percentage with the central bank.

When prices are rising, the central bank raises the reserve ratio. Banks are required to keep more with the central bank. Their reserves are reduced and they lend less.

When the reserve ratio is lowered, the reserves of commercial banks are raised. They lend more and the economic activity is favorably affected


INDIVIDUA/
INVESTORS/
BUSINESSM
AN
BANK
BUSINESSM
AN/INVEST
OR/INDIVID
UAL

BANK RATE POLICY

The bank rate is the minimum lending rate of the central bank at which it rediscounts first class bills of exchange and government securities held by the commercial banks.

When the central bank finds that inflationary pressures have started emerging within the economy, it raises the bank rate. Borrowing from the central bank becomes costly and commercial banks borrow less from it.

The commercial banks, in turn, raise their lending rates to the business community and borrowers borrow less from the commercial banks. There is contraction of credit and prices are checked from rising further. On the contrary, when prices are depressed, the central bank lowers the bank rate.