

# UNIVERSITY OF THE PEOPLE

BUS 1104-01 Macroeconomics- AY2024-T1

Learning Journal Unit 6

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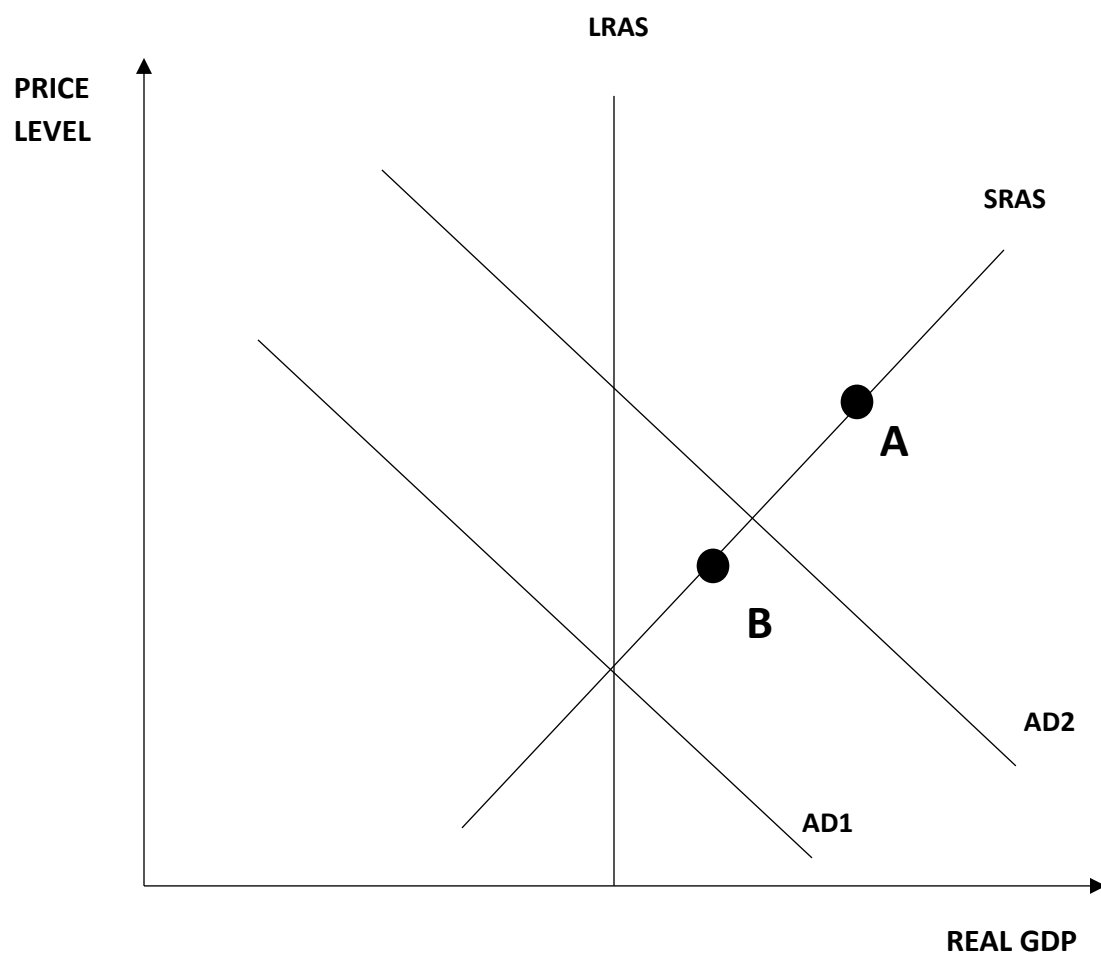
## 1. The Impact of Monetary Policy on Economic Activity

The activities performed by a country's central bank to regulate the amount of money and credit available to the economy are referred to as monetary policy. The major methods employed by central banks are interest rate changes, reserve requirements for banks, and open market operations for buying and selling government bonds. These tools impact economic activity in several keyways:

- Interest rates affect consumption and investment spending. Lower interest rates make it cheaper for consumers to borrow and spend on big purchases like homes and cars. Lower rates also reduce the cost of capital for businesses, encouraging more investment spending on new plants, equipment, and projects. Higher rates have the opposite effects.
- Reserve requirements determine how much money banks must hold versus lend out. Higher requirements force banks to hold more reserves and lend less, tightening credit availability. Lower requirements free up lending capacity.
- Open market operations add or drain reserves from the banking system. Buying bonds injects new money into circulation, while selling bonds removes money from the system. More money stimulates spending, while less money restricts it.

By adjusting these policy levers, central banks aim to stabilize prices and promote full employment and growth. For example, if inflation is too high, a contractionary policy raising interest rates and reserve requirements would reduce money supply and aggregate demand. This cools off an overheating economy and brings down price levels.

The following graph is showing the effects of a contractionary monetary policy:



As the graph shows, tightening monetary policy shifts the aggregate demand curve leftward. This reduces total spending in the economy, bringing down the price level. It also lowers real GDP relative to potential output, closing the GDP gap. The policy successfully fights inflation but also risks increasing unemployment if done excessively. Moderation is required to achieve a soft landing back to full employment and potential output.

## 2. Exchange Rate Impacts on Multinational Firms

Exchange rates determine the relative price of currencies and affect import and export prices. When exchange rates fluctuate, they alter the profits and competitiveness of multinational corporations like Motorola.

If the U.S. dollar appreciates against the Mexican peso, this makes Motorola's exports to Mexico more expensive for Mexican consumers. The dollar rising 10% versus the peso would increase the peso prices of Motorola's phones by 10%. This reduces demand from Mexican customers, lowering Motorola's Mexican revenues. It also makes Motorola less competitive against rivals producing locally in Mexico with pesos.

Meanwhile, the appreciating dollar makes imports into the U.S. from Mexico cheaper. This lowers Motorola's costs of importing components or finished products from Mexico. However, this cost saving is likely outweighed by the larger negative revenue impact of reduced Mexican sales.

Overall, an appreciating dollar reduces Motorola's foreign revenues more than its foreign costs, hurting net exports and profits. The company would see improved revenues and competitiveness in Mexico if the dollar depreciated instead. Multinationals can hedge their exchange rate exposure using derivatives and by matching revenues and costs in the same currencies. But fluctuating rates still impact multinational performance, necessitating close monitoring of currency markets.

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Reference:

Greenlaw, S., & Shapiro, D. (2017). Principals of macroeconomics 2e. Openstax. Licensed under CC-BY 4.0. <https://openstax.org/details/books/principles-macroeconomics-2e>

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