aggregate demand and inflation would be checked.

MONETARY POLICY

Monetary policy is the oldest policy for economic stability. "It is a policy which is adopted by the central bank of the country to control the supply of money". We can say that all those methods which are adopted by central bank of the country to control the supply of money are called the monetary policy. In simple words, monetary policy means monetary management. In the words of Harry G. Johnson, "It is a policy of central bank to control the supply of money with the aim of achieving macroeconomic stability".

INSTRUMENTS OR TOOLS OF MONETARY POLICY

They are classified into

1. Quantitative Methods
2. Qualitative Methods

1. Quantitative Methods. They consists of those methods which physically affect the amount of credit creation in the economy. They are as:

1. Changes in Bank Rate Policy or Rediscount Rate

The rate at which the central bank of the country gives loans to commercial banks is known as Bank Rate or re-discount rate. In Pakistan, State Bank charged 10.25% as bank rate in March 2019. By changing such rate of interest, the central bank can influence the supply of money in the country. To control inflation the central bank increases the rate of interest. The commercial banks will also increase their rate of interest. Accordingly, the loans will decrease, investment, output and prices will fall. In this way, inflation will be controlled. Now, we assume that the country is facing deflation. To remove deflation central bank will decrease the bank rate, the commercial banks will also decrease the rate of interest. In this way, people will get more loans. Investment production, employment and prices will start rising up. Accordingly, deflation will be controlled.

2. Open Market Operation

This is the second instrument of the monetary policy. Under this technique, the central bank sells or purchases government securities. If the central bank finds that commercial banks are providing excessive loans which are creating inflation. To remove the inflation, the central bank sells the government securities. The commercial banks will purchase these securities to earn interest against such securities. In this way, the resources of commercial banks will go down. They will advance less loans. Accordingly, the inflation will be controlled. If there is deflation in the economy. To control the deflation, the central bank purchases the government securities. Then the monetary base of the commercial banks will increase and their loaning power will increase. As a result, investment will increase, income and prices will go up.

3. Changes in Reserve Requirements

Each commercial bank has to keep a certain proportion of its deposits in the form of reserves just to meet the demands of the depositors. As in the case of Pakistan, each commercial bank has to keep 30% of its deposits to meet the needs of its depositors. The central bank can influence this reserve rate. If the central bank realizes that the commercial banks ar advancing excessive loans, it will increase the reserve requirements Accordingly, commercial banks could advance less loans.

On the other hand, in deflation, if the central bank reduces the reserve requirements, the commercial banks will be able to advance more loans. Hence, deflation could be removed.

4. Changes in Reserve Ratio

Each commercial bank has to keep a certain ratio of its deposits with central bank. In case of Pakistan, each commercial bank has to keep 5% of its deposit in the central bank. By changing the reserve capital, a central bank can control the supply of money by commercial banks. When there is inflation in the economy. To remove this inflation, the central bank will increase the reserve ratio. As a result, lending of commercial banks will fall. As a result the supply of money will decrease. On the other hand, if central bank decreases the reserve ratio, the commercial banks will be having more funds to advance. Accordingly, the deflation could be controlled. But if the commercial banks have excess reserves, the minor changes in reserve ratio will not reduce their loaning power.

5. Changes in Marginal Requirements

Commercial banks do not give loans against leaves, rather they ask for pledges to make. How much a person will have to pledge is settled by the central bank. This is given the name of marginal requirement. The central bank can bring changes in the marginal requirements. If there is inflation in the economy, the marginal requirements will increase. In this way, people will get less loans. As a result, supply of money will decrease. During deflation the marginal requirements are decreased. Hence people will get more loans from the commercial banks. As a result supply of money will go up and deflation will be controlled.

6. Credit Ceiling/Rationing of Credit

The central bank can issue directions that loans will be given to commercial banks upto a certain limit. As a result, the commercial banks will be careful in advancing loans to the people. But this is a very strict method, hardly adopted by the central bank. Moreover, if the commercial banks are having other sources to borrow, they will not bother for this policy.

2- QUALITATIVE METHODS

1. **Moral Suasion** It is concerned with just as a moral request by central bank to commercial banks that loans should not be given for unproductive fields which create inflation. Again loans should not be given for speculative purposes and hoarding. But such like requests could be effective in the developed countries.

2. **Consumers Credit Control** This instrument is applied during inflation. If the central bank wants to control the supply of money, it will issue directions to commercial banks that loans should not be advanced for consumption purposes or for consumer durables because they create inflation. Again, under this method the central bank can direct the business concerns who sell the goods on instalments to raise their down-payments.

3. **Direct Action** The instrument of direct action is concerned with the policy of central bank against commercial banks. It can refuse to give loans to commercial banks. The central bank will not advance loans to commercial banks for the sectors which create inflation. Moreover, if commercial banks do not follow the instructions of the central bank, it will

refuse to lend commercial banks. But this is a very strict method, it is hardly adopted by central bank.

4. **Publicity** The central bank of the country is the overall incharge of economic stability of the country. Its aim is to protect the economy from inflation and deflation. For this purpose, it analyses the whole economy. It keeps an eye over the activities of the commercial banks. If the commercial banks are found advancing loans which create inflation, their activities will be unhealthy for whole economy. The central bank can blacklist such banks. Thus to avoid such bad reputation in future, they will be careful in advancing loans.