**BEAM033 Final Assignment**

Student's Name

Institution Affiliation

Course Number and Name

Instructor Name

Date

Individual Reflective Report

**TASK ONE**

1. **Given the circumstances, is the Central Bank likely to adjust its monetary policy? If so, what would you expect?**

In this case, the Central Bank must find a strategy for adjusting its monetary policy to return the economy to its normal state. Regardless of other economists'' need for recession, the Central Bank should act swiftly and apply financial tactics to save such an economic crisis. Below are some of the recommendations on what should be done;

***Modification of Reserve Requirements***

The first advice is that the Central Bank needs to modify reserve requirements. By reducing the reserve requirements, banks and financial organizations allow them to loan more money to borrowers, increasing money circulation. This mechanism was applied on December 28, 2000, and worked effectively. Depository firms were given a directive to hold a reserve of 3% against 42.8 million dollars in their net transactions and a corresponding 10% against net transaction accounts which exceeds 42.8 million USD ("FEDERAL RESERVE BANK of NEW YORK,” 2022).

***Conducting Open Market Operations***

From Lecture 8 notes, Open market operation is among the best action which Central Bank can use to control the economy. In this case, the applied increased rates greatly affected the state of the economy. Trying to instill a balance of payments deficit, the central bank is likely to encourage the purchase of treasury bills government stimulating an increase in the money supply. Open Market Operations has been applied successfully by the Indian government to control their economy, and it has worked right.

***Adjusting Short Term Interest Rates***

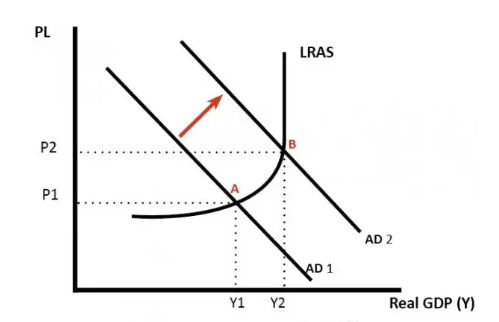
The Central Bank should lower the discount rates that commercial organizations must pay when borrowing short-term loans. This will encourage banks to borrow more within a short time. The rates relieved to borrowing banks and commercial institutions will result in similar lower interest charges to other borrowers. Therefore, that will be a good deal of injecting more money into the public hence improving economic status.

**2. Recently, the Central Bank has allowed the money supply to expand beyond its long-term target range. Does this affect your expectation of what the Central Bank will decide at its upcoming meeting?**

Income inflation and expansion are directly associated with an increase in the money supply in the economy (Lecture Notes by Professor Angela Christidis). When it is realized that money circulation in the country is rising beyond expectation, expansionary factors are at work. That calls for anti-inflationary policies to be put in place to control that scenario.

Central Bank allows expansion of the money supply beyond its long-term target range, which is likely to result in an economic pandemic. In the coming meeting, the Central Bank needs to respond to that and apply the possible mechanisms for controlling the amount of money circulation in the economy. Otherwise, this will result in misfortunes like hyperinflation, where prices of goods and services will rise beyond expectation.

If the Central Bank allows excess money in circulation, individual purchase power will increase. As a result, there will be a higher demand for goods and services than supply. A long last will be demand-pull inflation putting upward pressure on prices that followa shortage in supply. The graph below is a clear illustration of demand-pull inflation.



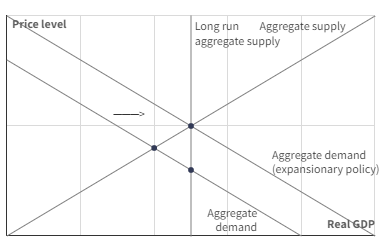
When overall demand "AD" increases, the Production Capacity "LRAS" firms respond by hiking prices.

When hyperinflation is affected, it leads to a change in consumer behavior. People tend to be forced to shift to hoarding goods from their customers, anticipating a price increase. In most cases, hoarding starts with durable goods such as machines and automobiles. In some cases, like when there is intense hyperinflation, people will hoard even perishable goods. The result is that daily goods become less available and costly. That is a precise prediction of a declining economy, and the central bank must respond to rescue such a situation. Hyperinflation makes most individuals lose savings, and cash loses value. After such a scenario, it is evident that commercial banks and other financial lending organizations become bankrupt because people stop depositing.

Hyperinflation links the country's currency with [foreign exchange markets](https://www.thebalance.com/foreign-exchange-market-3306088). The nation's importers are expected to go out of the business field as the cost of foreign goods continues to skyrocket. As a result, government revenues decline, and the trouble of providing efficient goods and services to its people begins. Suppose the government takes the wrong idea of printing more money to pay for its bills and debts, which will escalate hyperinflation. According to economists, there are two winners in hyperinflation. The first beneficiaries include those individuals who managed to take loans from the central bank. Hyperinflation results in currency devaluation, making debts worthless and their loans wiped off. The other group is the exporters. The falling of the value of the local currency makes exports less expensive compared to foreign competitors. Similarly, exporters receive foreign currency, which may increase the local currency.

**3. Suppose the Central Bank has just learned that the treasury will need to borrow more funds than initially expected. Please explain how this information may affect how the Central Bank changes its monetary policy.**

Government borrowing has a significant impact on the economy. When the treasury borrows, funds are transferred from the lender account to the government account in exchange for government securities. The Central Bank can control government borrowing through legislative action or monetary policies. After the Central Bank has detected that the government intends to borrow more than its previous records, it adjusts its economic policies as a strategy of either encouraging or discouraging borrowing. Like in this case, the government is to take expansionary monetary policies. The Central Bank uses this policy to boost the state economy during a recession period. By adjusting interest rates and borrowing costs, the National treasury will find borrowing a good deal—the diagram application of expansionary policy results in the proper shifting of the demand curve. The diagram below shows an illustration of expansionary policy.



Another monetary policy expected to be applied by the Central Bank is the reducing interest rates. The lower the interest rate, the higher the predicted borrowing rate expected. This makes the national treasury encouraged to borrow more from the central bank. The interest rate reduction will be based on the number of loans requested. That is to say, the set standard to reduce loan interest rates will be placed on heavy borrowing. By doing so, the government will be encouraged to make borrowing purposely to get more for investment.

Additionally, the macro-prudential policy has been used to explain the change in monetary policies by the Central bank. The efficacy of some policies is shown to rely on the policy’s aim to loosen or tighten. These policies ensure that the financial system is stabilized to prevent further disruptions in financial services and credit essential for the economy’s growth. For instance, when DSTI and LVT ratios are tightened to reduce the house price growth and housing credit. However, this loosening of ratios does not directly impact economic growth. The variation in the effectiveness of loosening and tightening policies goes beyond housing. The Central Bank needs to ease the credit score of borrowing. By checking on previous records and conditions for lending, the central bank will need to adjust the terms and conditions that will favor the national treasury to borrow. Also, it is in order if the central bank will increase the refunding period for heavy borrowing. That will sound interesting for the treasury to borrow more than the previous limit.

**4. You believe that if the Central Bank does not revise its monetary policy, the economy will continue to decline. If the Central Bank stimulates the economy at this point, you believe that stocks would outperform bonds. Based on this information, do you think the company should switch its bond holdings to stores? Consider the typical sources and uses of funds at each company unit. Explain how your recommendation will affect each unit's performance.**

The company should not switch to stocks. The falling of stores requires investors such as companies to pay low prices for their future growth. The classical element of "buy low, sell high" assumes that a few companies can practice due to the increased fear of a downturn in the market during inflation. During the economic recession period, the company acknowledges the closeness of equity investments to the bottom, topping all valuations of units. Calls may be on their journey severally to rebound already. The recession period should include preparing a company for the economy's rebounding. The company investors should understand that inflation is the best time for preparation for a rebound. These preparations may include the investment of relatively safe elements such as bonds.

However, bonds deliver lower returns than stocks historically due to the increased risk. The increased risk is possible because a company's fall leads to the loss of all investments by stockholders. For bondholders, the lending may be partially or fully recovered. An anticipatable income streak is an assurance to the company when it holds a bond. Holding bonds to maturity is a possibility of getting back the whole principal to the holders of the bonds, which is a way of capital preservation Bali, Brown, Demirtas, (2013). Therefore, companies should implement a plan of outperforming the market by holding on to bonds that increase other units'' performance.

**5. What is your forecast of how recent, existing, or potential regulations will affect each unit's performance?**

The recent, existing, or potential fiscal and monetary regulations, such as macro-prudential policy, affect units'' performance. After the global budgetary crisis (recession), the monetary policy was eased to enhance credit easing while ensuring that the interest rates were reduced. However, this was limited to cutting approaches further, including the limited unusual options. The Central bank came up with monetary policies resulting from deflation danger. The individual policies included buying long-term bonds in the UK to loosen financial conditions while lowering the long-term rates. Likewise, the central bank responded to the pandemic by undertaking unmatched policies to reduce the monetary policy restrictions while maintaining credit flow and enhancing liquidity flow into markets. As a result, the performance of units of companies was increased through the programs of increased purchase of units.

**Task One References**

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Lecture Notes by Professor Angela Christidis

**TASK TWO:**

**Q5. CENTRAL BANK**

**a. What are the advantages and disadvantages of quantitative easing as an alternative to conventional monetary policy when short-term interest rates are at the effective lower bound?**

Regarding money-related arrangements, quantitative facilitating alludes to how a national bank procures enormous amounts of government securities or other monetary resources to siphon assets into the economy to animate financial action. The national bank does this by buying monetary resources from business banks and different monetary establishments, supporting the costs of those monetary resources and diminishing their yields while simultaneously expanding how much cash is available. The national bank might use quantitative facilitating to assist a country's economy with developing rapidly. It can help with delivering the economy once again from the downturn. When Coronavirus welcomes the current downturn, the national bank might utilize quantitative facilitating to assist with fixing what is happening. It guarantees that the expansion rate doesn't fall underneath the national bank's objective pace of expansion.

Rather than everyday open market tasks, quantitative facilitating involves the acquisition of additional unsafe resources for an enormous scope over a pre-decided time allotment, which is opposed to the conventional open market activity. Presently, for a situation where the financing cost is at the zero-lower limit, the quantitative facilitating project will answer by forestalling the momentary loan fee from falling any further, which will help with the monetary recovery. Besides, one of the benefits of this method is that it can thaw the market by providing liquid and so, assisting the economy (Gagnon, 2016). When a financing cost focusing on the system is utilized to drop transient loan fees to their zero cutoff points, it is a better procedure than customary strategies for this situation. Quantitative facilitating prompts diminished loan costs, implying financing costs will lessen in the short and medium-term.

Nonetheless, if loan costs rise impressively over the long haul, this will invigorate the economy. The pace of expansion affects the loan cost. The more prominent the expansion rate, the more likely the loan fee will increase. This is since banks are requesting higher financing costs to make up for the decrease in the purchasing worth of the cash they will get soon. Because of the low inflationary climate, loan costs are lower. The expansionary financial strategy will be inadequate since it will deal with a similar frequency as the loan fee decreases to animate monetary movement. To improve total interest, the financing cost will be diminished. The indistinguishable situation with low expansion will increase genuine interest because the loan fee is reduced. As a result of this situation, the expansionary financial approach will be insufficient.

**b. If “inflation is always and everywhere a monetary phenomenon,” why did the huge expansions of central bank money by the Federal Reserve, the ECB, and the Bank of Japan between 2007 and 2018 not result in high inflation in those economies?**

A rise in prices over a while is known as inflation. The rise in a country's total price level or the cost of living is often used as a broad indicator of inflation, for certain products, like food, or services, like a haircut. Inflation is a proportion of how much a specific arrangement of items or potentially benefits has expanded in cost throughout a given timeframe, most frequently a year. Other duties include leading committees that investigate temporary topics, including consumer banking legislation and internet commerce, which the Board of Governors is expected to steer in its monetary policy actions.

In addition, the Board of Governors manages the nation's payments system, implements consumer protection rules, and supervises the financial services sector. It is the Board's responsibility to approve the nominations of Reserve Bank presidents and select board members. Reserve Banks provide recommendations to the Board on adjustments to discount rates, and the Board acts on such recommendations.

The banks that were hired used quantitative easing. A procedure in which the Central Bank boosts the money supply in the economy by acquiring government bonds is known as quantitative easing. Increased employment rates and reduced interest rates are among the benefits of this technique, which also has negative consequences.

The Federal Reserve is a financial institution that was established in 1913. The Central Bank's primary goal is to keep inflation from rising too quickly and uncontrollably. The Central Bank achieved this via quantitative easing (Hansen, 2016). The bank acquires government bonds, which lowers interest rates on loans and investments, encouraging banks to lend money, supporting investment in the economy, and increasing the value of stock market assets.

Furthermore, due to the large number of bonds purchased by the Federal Reserve, the Federal Reserve Bank's balance sheet rose quickly. The inflation rate remained below but close to the 2% mark on a medium-term basis. The European Central Bank (ECB) is a European financial institution. With quantitative easing, the European Central Bank (ECB) acquired bonds from banks, expanding the amount of money in the economy. Due to the decreased interest rates, more individuals could borrow money from the bank, and repaying loans became less burdensome. As a result, the aggregate demand for goods and services rose, as did investment rates, and the economy developed, creating additional employment opportunities. Over the longer term, the European Central Bank successfully kept inflation below but close to 2%.

The Bank of Japan is a financial institution in Japan. The Bank of Japan used quantitative easing to battle deflation and economic recession. By purchasing government bonds and releasing liquidity into the economy, the Central Bank was able to stimulate expenditure in the economy and, as a result, restore it. This technique, however, was not successful in Japan in terms of reviving the economy and eradicating deflation.

**c. Following the coronavirus pandemic in March of 2020, the Federal Reserve announced that it reduced the reserve requirement to zero as the size of the Fed’s balance sheet approached $6 trillion. What might be the rationale for implementing such a change?**

Following the virus outbreak, the Federal Reserve decided to decrease the reserve requirement to allow the economy to recover. It is vital to make this adjustment in light of the significant number of bank failures due to the global financial crisis. Furthermore, due to the harsh economic environment generated by the pandemic's effect on employment, many customers turn to debt to make purchases. Reserve requirements were reduced to aid in expanding the economy and encourage banks to provide credit. Because of this policy change, depositors may not claim the Federal Deposit Protection Corporation (FDIC).

Another rationale for lowering the reserve requirement is that banks currently have $1.5 trillion in excess reserves, which is another justification for lowering the reserve requirement. To stimulate economic growth, it may be necessary to channel these excess reserves into bank lending or other financial transactions. Because of the financial crisis, banking rules were amended regarding the reserve requirement, making it illegal for banks to invest money over their required reserve level. This is one of the reasons why banks hold surplus reserves.

Also feasible is that a reduction in the reserve requirement will increase the money supply, which would aid in stimulating the economy (Bernanke, 2017). Several economists have shown that increasing the quantity of money in circulation is a more effective means of growing an economy.

At the moment, banks have $1.5 trillion in excess reserves, but they cannot lend or invest these funds. If a central bank is required to spend its own money to stimulate economic growth, it should be avoided for the public to preserve confidence in the reserve system. United States Constitution bars the president from implementing policy changes without obtaining congressional authorization.

While it seems beneficial to the economy, the Federal Reserve takes on a function that it was never intended to fulfill. Neither the Federal Reserve nor its members have the power to lend or spend their own money. The Federal Reserve Bank of New York has taken on the role of a Keynesian monetary stimulus for the central bank to raise interest rates rather than focusing on ways to stimulate economic growth further, as was previously done.

**References**

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Lecture Notes by Professor Angela Christidis