E216 : Economics of MONEY AND BANKING

Second grade

First term

Dr Doaa Akl Ahmed

Associate Professor of Economics

Benha University

Chapter 14 and 16

Management of monetary policy: objectives – tools and types

Learning outcome

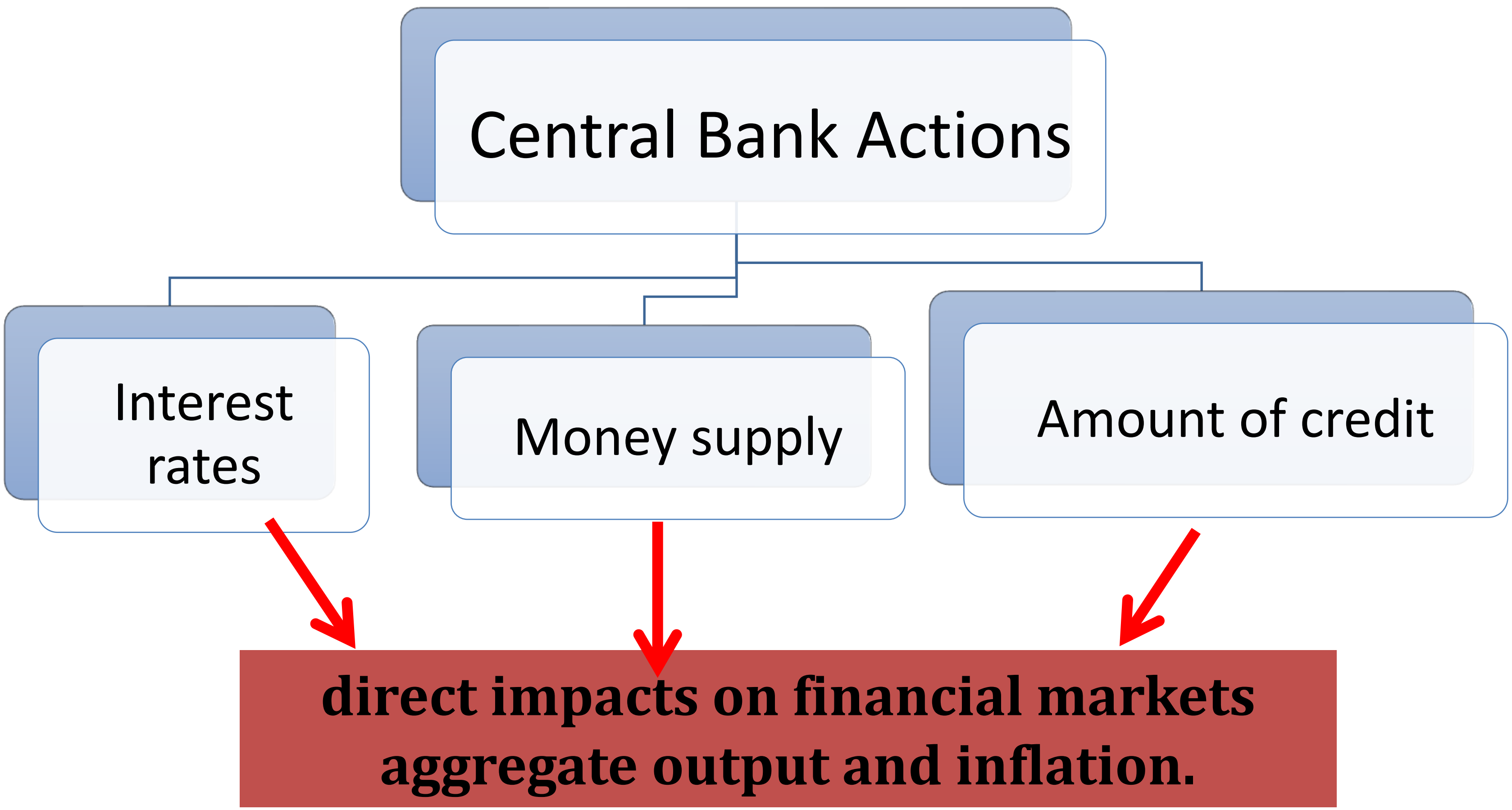
1. The key objectives of monetary policy
2. The main functions of the central banks
3. Conventional Tools of monetary policy
4. Expansionary versus contractionary monetary policy

1. key objectives of monetary policy

1. Price stability: low inflation rate
2. high employment and output stability
3. economic growth
4. stability of financial markets
5. interest-rate stability
6. stability in foreign exchange markets

2. Main functions of Central banks

Central banks are the government authorities in charge of monetary policy.



2. Main functions of Central banks

1. Clear checks
2. Issue new currency
3. Withdraw damaged currency from circulation
4. Administer and make discount loans to banks.
5. Evaluate proposed mergers and applications for banks to expand their activities
6. Collect data on local business conditions
7. Use their staffs of professional economists to research topics related to the conduct of monetary policy

3. Conventional tools of Monetary policy

- During normal times, Central banks use three tools of monetary policy to control the money supply and interest rates:

1. **discount lending:** providing discount loans to commercial banks
2. **open market operations**: purchases or sale of government securities in the open market
3. **reserve requirements:** setting the required reserve ratio

3. Conventional tools of Monetary policy

used to control

Tools for Monetary Policy

- Open Market Operations
- Discount Loans
- Changes in Reserve Requirements

→

Targets for Monetary Policy

- Money Supply
- Interest Rates

↓ set to achieve

Goals for Monetary Policy

- High Employment and Growth
- Price Stability or Low Inflation
- Financial Market and Interest Rate Stability

4. Expansionary vs Contractionary monetary

Expansionary monetary policy

- It is used to overcome recession or depression.
- When there is fall in consumer & business demand, the central bank

  1. Decrease discount rate.
  2. Purchases securities through open market operations.
  3. Lowers the reserve requirements

These procedures lead to an upward shift in the AD

4. Expansionary vs Contractionary monetary

Expansionary monetary policy

1. Decrease discount rate.
2. 2.Purchases securities
3. 3.Lowers the reserve requirements

↓

An increase in the money supply

↓

A fall in interest rate

↓

An increase in Investment and consumption

↓

An increase in the aggregate demand

4. Expansionary vs Contractionary monetary

Contractionary monetary policy

- It is used to overcome inflation
- When there is an increase in inflation rate due to high aggregate demand, the central bank

    1. Increase discount rate.
    2. sells securities through open market operations.
    3. Raises the reserve requirements

These procedures lead to a downward shift in the AD.

4. Expansionary vs Contractionary monetary

Contractionary monetary policy

1. Increases discount rate.
2. 2. Sells securities
3. 3. raises the reserve requirements

A decrease in the money supply

A rise in interest rate

A decrease in Investment and consumption

A decrease in the aggregate demand

Inflation decrese