presentation 18
assessing monetary policy

Monetary policy

Monetary policy refers to the process whereby the monetary authority, the central bank, determines the size and rate of growth of the money supply according to the following variables:

- I-rate
- Money supply
- E-rate
- Domestic financial needs
- Foreign financial needs

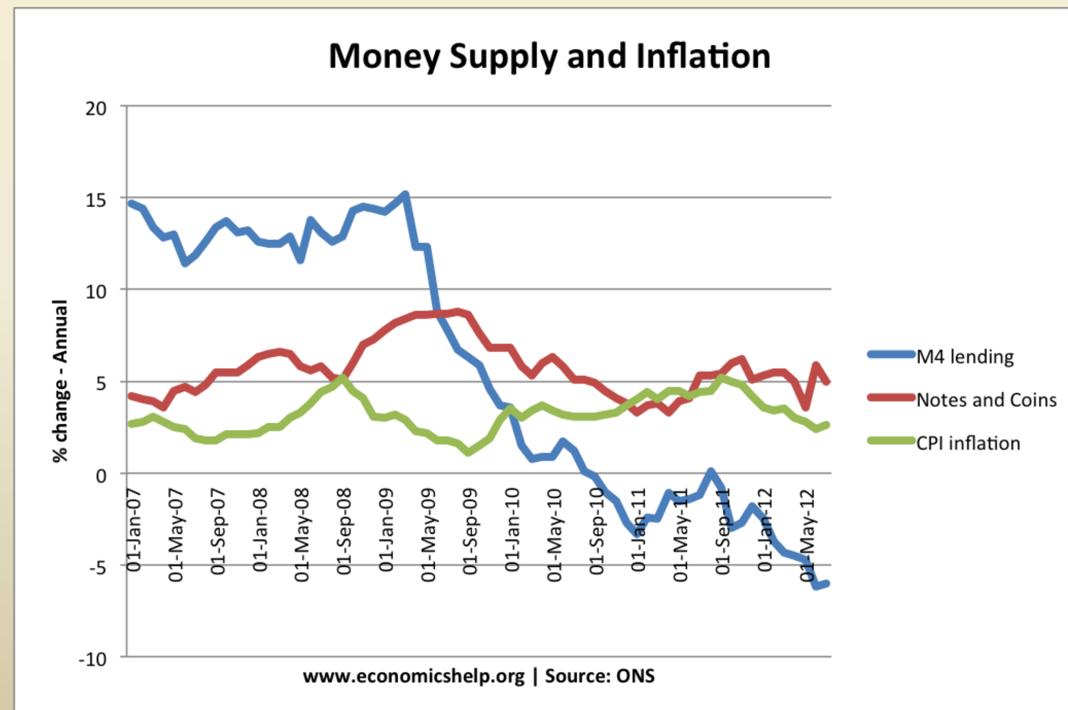
I-rates

Having a unified i-rate policy that pleases all the actors is impossible

- Borrowers, individuals or organizations using funds on credit are avid for low interest rates
- Lenders, individuals, or organizations advancing cash to a borrower seek to impose high interest rates or seek high-interest opportunities for their investment; the banks are also keen on having high rates for their own profitability

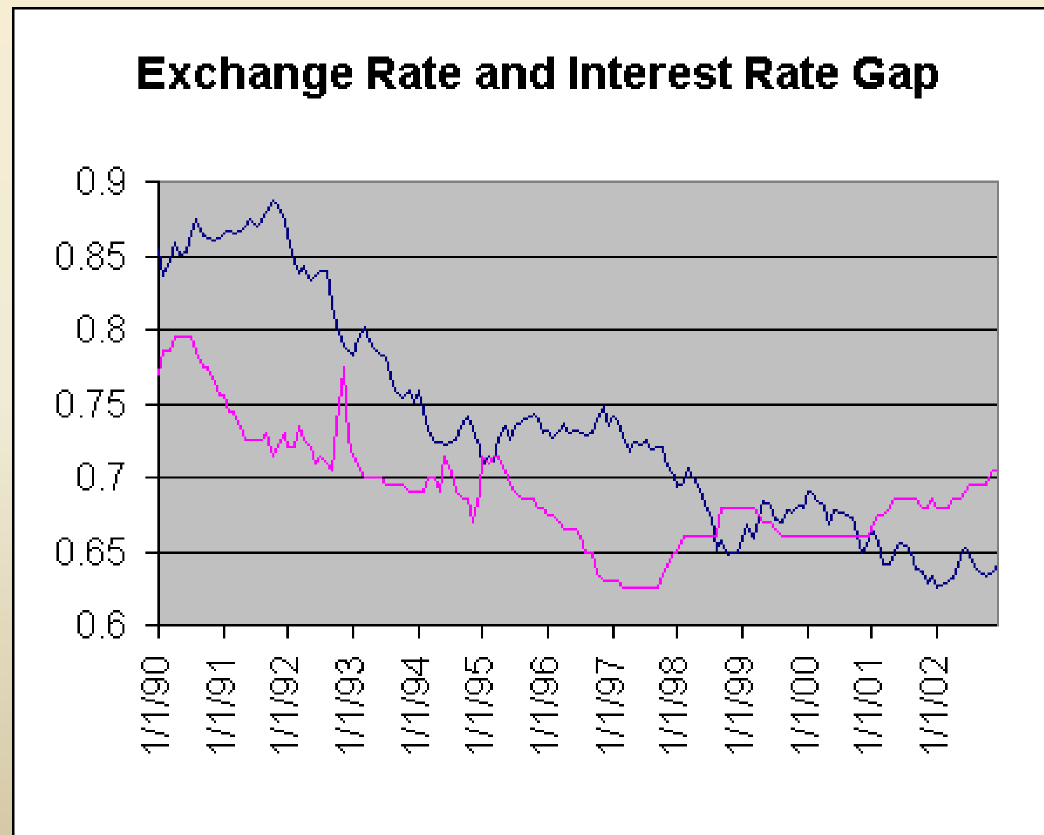
The money supply

Monetarists claim that important money supply is detrimental to the economy: an increase in M without a corresponding increase in L lowers i-rates fuelling consumption and thus inflation through demand-side policies (demand-push inflation); is it the case?



The e-rate

E-rate sand i-rates tend to work in opposite directions: an appreciation of the domestic currency is accompanied by a fall in the i-rate particularly for exporting economies (International Fischer effect)



Limitations

Monetary policy has its limitations:

1. Since it is based on the confidence that the central bank is able to use its monetary policy to combat inflation it may not actually achieve it – this situation is referred to as “liquidity trap” – bringing about a confidence crisis.
2. It is difficult to control many objectives with one tool in an open economy.
3. Are not compatible with fiscal policies crowding out the positive effects (and vice versa)