

Monetary Economics

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Ans1a. MONETARY POLICY AND WHO FORMULATES IT:

Monetary policy, the demand side of economic policy, refers to the actions undertaken by a nation's central bank to control money supply to achieve macroeconomic goals that promote sustainable economic growth. There are two reasons why central bank carries out monetary policy: (investopedia)

- EXPANSIONARY MONETARY POLICY:

This is when the central bank lowers the interest rates in the economy in order to encourage borrowing and discourage saving. Its purpose is to increase the aggregate demand in the economy. It is mainly used in recession.

- CONTRACTIONARY MONETARY POLICY:

This is when the central bank increases the interest rates in the economy in order to reduce the amount of spending. Its purpose is to decrease the aggregate demand in the economy. It deals with inflation.

QUANTITATIVE TOOLS OF
MONETARY POLICY

- Open Market Operation:

The conduct of open market tasks alludes to the purchase or sale of government securities by the SBP to the banking and non-banking open for liquidity management purposes to keep loan costs in the line with its financial arrangement goals. They are normally short term operations carried out when economic situation wants.

- Discount Rate:

Discount loan is the loan on which the interest and financing charges are deducted when the loan is issued. Discount rate is the interest rate charged to commercial banks for loans received from the central bank's discount window.

- Change in Reserve Ratio:

Reserve ratio is a specific minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank. It is set according to the guidelines of the State Bank of Pakistan.

- Cash Reserve Ratio
- Statutory Liquidity Requirement

(lecture)

Ans1b. Corona has affected all the businesses around the world. The major effect of this virus is on fuel business. If solid precautionary measures are not taken it could affect the world economy. The government of Pakistan diminished the interest rate what might be its consequences on businesses. Would it be good for our country?

In the event that the loan fee is diminished by the State Bank of Pakistan different banks will do likewise. So everybody could take loans from banks and start their own businesses and can invest their money in different businesses if they don't want to start a new venture spite of the fact that this would raise the inflation rate. So I guess the government should decrease interest so that people can easily set up their businesses and overcome the losses caused due to Covid-19. Government could not bear losses in the taxes due to Corona. There is 15% decline in the tax revenue.

The income that is earned from the charges and distinctive guide programs government helps the individuals who couldn't exert their costs in this pandemic. The main way that government could those by foeign nations pr by taking out the assets in the running tasks. However, it seems that none of it is conceivable on the grounds that outside the nations are in a similar state wherein we are and taking out cash from the running ventures would additionally postpone the tasks.

Ans2a. INTEREST RATE

The cost of borrowing money, expressed as a percentage of the loan amount.

A loan that is considered low risk by the lender will have a lower interest rate. A loan that is considered high risk will have a higher interest rate.

REAL INTEREST RATE

V/S

NOMINAL INTEREST RATE

| NOMINAL INTEREST RATE | REAL INTEREST RATE |
|---|---|
| A nominal interest rate refers to the interest rate before taking inflation into account. | A real interest rate is adjusted to remove the effects of inflation and gives a real rate of a bond or loan. |
| For example, If you have deposited \$100 in your bank account and your bank is offering a 5% per annum interest rate, you will have \$105 ($100 + 0.05 \times 100$) in your account by the end of year. | For example, Depositing money in a bank will give us 5% interest and we will earn \$5 in interest. But if the inflation is 3% per annum, it means that goods and services which we can buy at, say \$100, we have to pay \$103 now for the same amount of goods & services. So we have earned only \$2 ($\$5 - \3). |
| Nominal interest rate does not include inflation effect. | Real interest rate includes inflation effects. |
| Nominal interest rate cannot be less than zero. | Can be less than zero if inflation is more than nominal rates. |
| Nominal rates will tell us what is happening in the market and it is moving. It is not the actual return we will get. | Real rates will tell us the actual return we will get from the investment after adjusting the inflation effect. |

(investopedia, educba)

Ans2b. MONEY MARKET

The money market involves the purchase and sale of large volumes of very short-term debt products, such as overnight reserves or commercial papers.

FUNCTIONS OF MONEY MARKET

- Provides a place for warehousing surplus funds for a short period of time.
- Borrowers for the money market provide a low-cost source of temporary funds.
- Corporations and governments use these markets because the timing of cash inflows and outflows are not well synchronized. Money markets provide a way to solve these cash-timing problems.
- Transfer funds
- Serves as a pricing benchmark.
- Provide liquidity to investors.

IMPORTANCE OF MONEY MARKET

- Development of trade and industry
- Development of capital market
- Smooth functioning of commercial banks
- Effective central bank control
- Formulation of suitable monetary policy
- Non-inflationary source of finance government
(slideshare)

Ans3a. FOREIGN EXCHANGE MARKET AND HOW IT WORKS

A market where participants buy, sell and exchange currencies.

It includes three types of transactions:

- SPOT
In the case of the US dollar for the Canadian dollar settlement is on the next day of the transaction.
- FORWARD
It involves an agreement today to buy or sell a specified amount of a foreign currency at a specified future date at a rate agreed upon today.
- SWAP
A sale of a foreign currency with a simultaneous agreement to repurchase it at same date in the future. Swap rate is the difference between the spot and forward rates in the currency swaps.

It consists of two tiers:

- The inter bank or wholesale market
- The client or retail market.

Ans3b. Total outlay of budget 2020-21 is Rs. 7,294.9 billion. This is 11 percent lower than the size of budget estimates 2019-20. The net revenue receipt for 2020-21 have been estimated at Rs. 3699.5 billion indicating an increase of 6.7 percent over the budget estimates of 2019-20. The overall expenditure during 2020-21 has been estimated at Rs. 7294.9 billion, out of which the current expenditure is Rs. 6345 billion.

After analyzing the budget 2020-21, I am in support of the budget and the strategies which are suggested in it by the officials. This plan may seem to be not as useful enough but is an effort to ease the problems of Pakistan as:

- The government is determined to announce a pro-people, pro-business and no new tax budget for the next fiscal year starting July 1. Rather the FY21 budget would be a continuity of the current policies of facilitating the masses and businesses to win the war against the coronavirus pandemic.
- The government's prime focus is on providing relief for people and businesses rather than tax generation till the disease comes under control. The budget will most probably be an effort to counter the negative impact of coronavirus on the economy budget.
- The government may increase debt to provide relief for people and businesses however they may lose around Rs. 800 billion in the revenue collection in the last four months (March-June) of the current fiscal year 2020, the upcoming budget can demonstrate a principled approach of resource generation through tax compliance; deficit reduction by curtailing expenditures; and finance the deficit by a shift to non-debt creating instruments.
- Shifting financing of budget to non-debt creating instruments, can restore the public flagging faith in the integrity of the policy makers to break the debt cycle. I emphasize that multi-rounds of monies for the vulnerable and businesses; and new growth supporting programmes succeeding survival strategy are needed to avoid recession.
- Both fiscal and monetary policies working together can ease the pain on the people of Pakistan.