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Question 1A Marks (07)

**What is monetary policy? Who formulates it and what are the quantitative tools of monetary policy?**

**Answer:**

Monetary policy is an economic policy that manages the size and growth rate of the money supply in an economy. It is a powerful tool to regulate macroeconomic variables such as inflation and unemployment.

Or

Monetary policy is the process by which the monetary authority of a country or central bank controls the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability

The central bank or a similar regulatory organization is responsible for formulating these policies.

**The quantitative tools of monetary policy are:**

* Open market operations: At inflation and boom, the central bank sells securities in the open market and withdraws the surplus money from circulation.
* Discount rate: during the period of deflation and depression the central bank lower the bank rate. Discount rate is the interest rate charged to commercial banks for loans received from the Central bank’s discount window.
* Change in reserve ratio: Every commercial bank is required to keep with central bank a certain percentage of its deposit reserve ratio.

When reserve ratio is raised, the commercial banks are forced to send more cash to the central bank cash resources of commercial banks

**Question 1B 8 Marks**

**What is the implication of Monetary Policy 2020 on our business activities in the recent pandemic situation?**

**Answer:**

In line with market expectations, Pakistan’s central bank has cut the benchmark interest rate by 100 basis points to 8% to help people, businesses and the economy fight against the corona virus pandemic.

Monetary Policy Committee has reduced the policy rate by 100 basis points to 8 percent.

The decision which is taken by MPC was reducing the interest rate and also price of domestic fuel. all business activities are decreased and business are in loss so by reducing the interest rate business are enable to take loan from banks and continue their business activities.

Businesses were provided payroll loans worth Rs96bn for a 3-month tenure at subsidized rate of 4%. As many as 775,000 borrowers were provided relief on repayment of Rs491bn in loan principals for one year, while Rs75bn worth of debt was rescheduled. Banks have been allowed to extend an additional Rs800bn in individual and business loans through an expansion of credit limits.

**Question2A 7 Marks**

**What is Interest rate? Differentiate between nominal and real interest rate?**

**Answer:**

An interest rate is defined as the proportion of an amount loaned which a lender charges as interest to the borrower, normally expressed as an annual percentage. It is the rate a bank or other lender charges to borrow its money, or the rate a bank pays its savers for keeping money in an account.

Interest rates are commonly used for personal loans and mortgages, though they may extend to loans for the purchase of cars, buildings and consumer goods.

**The nominal interest** rate is the percentage increase in money you pay the lender for the use of the money you borrowed. For instance, imagine that you borrowed $100 from your bank one year ago at 8% interest on your loan. When you repay the loan, you must repay the $100 you borrowed plus $8 in interest—a total of $108.

**The real interest rate** is the rate of interest an investor, saver or lender receives after allowing for inflation. It can be described more formally by the Fisher equation, which states that the real interest rate is approximately the nominal interest rate minus the inflation rate.

Or the difference between nominal and real interest rate is that A real interest rate is an interest rate that has been adjusted to remove the effects of inflation to reflect the real cost of funds to the borrower and the real yield to the lender or to an investor. A nominal interest rate refers to the interest rate before taking inflation into account.

**Question 2B 8Marks**

**What are money markets? Explain functions and importance of Money markets in Pakistan.**

**Answer:**

Money market refers to the market that deals with short term financial assets that are close substitutes of money, usually with maturities of less than one year.

Money market too has the primary market and secondary market

In the primary market, the government, securities like t-bills and government bonds are auctioned

The secondary market deals in trading of t-bills, government and corporate bonds, and the other money market instruments.

Money market enables the institutions with surplus funds to lend to those who have temporary fund shortages

Money markets serve five functions—to finance trade, finance industry, invest profitably, enhance commercial banks' self-sufficiency, and lubricate central bank policies

**Financing trade:**

The money market plays crucial role in financing domestic and international trade. Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market. The acceptance houses and discount markets help in financing foreign trade.

**Financing industry:**

The money market contributes to the growth of industries in two ways:

First they help industries secure short-term loans to meet their working capital requirement through the system of finance bills commercial papers

Second they giving idea about long term financial market

**Profitable investment**:

The money market enables the commercial banks to use their excess reserves in profitable investment. In the money market, the excess reserves of the commercial banks are invested in near-money assets (e.g., short-term bills of exchange) which are highly liquid and can be easily converted into cash. Thus, the commercial banks earn profits without sacrificing liquidity.

**Self-sufficiency:**

Commercial bank In the situation of emergency, when the commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higher interest rate. On the other hand, they can meet their requirements by recalling their old short-run loans from the money market.

**Help to central bank:**

Money markets help central banks in two ways: Short-run interest rates serve as an indicator of the monetary and banking conditions in the country and, in this way, guide the central bank to adopt an appropriate banking policy, Sensitive and integrated money markets help the central bank secure quick and widespread influence on the sub-markets, thus facilitating effective policy implementation

In Pakistan primary participants of money market are many like government of Pakistan, state bank of Pakistan, commercial, cooperative and saving banks.

Money market is not some predetermined tee up like commodity market but a name given to all financial institutions dealing with short term credit financing. Here highly liquid financial instruments are traded having maturities of one year or less, unlike the Secondary market that is set up for trade in Long term and Equity Financing.

**Question 3A 10Marks**

**What are foreign exchange markets and how it works?**

**Answer:**

The market in which people or firms use one currency to purchase another currency is called the foreign exchange market.

The foreign exchange market or forex market is the market where currencies are traded. The forex market is the world’s largest financial market where trillions are traded daily. It is the most liquid among all the markets in the financial world. Foreign exchange markets can be considered as a linkage of banks, nonbank dealers, and forex dealers and brokers who all are connected via a network of telephones, computer terminals, and automated dealing systems. Electronic Broking Services and Reuters are the largest vendors of quote screen monitors used in trading currencies.

The Forex (FX) market is the global marketplace for trading currencies. It is decentralized – in other words, it does not operate in one particular place as stock exchanges do. Anyone who buys or sells a particular currency is accessing the Forex market. So, if you’re taking your salary or pension from the UK to Pakistan, you’ll be using the Forex market to sell your pounds for PKR.

Of course, expats are far from the only people who need to exchange currency. International trade requires big and small businesses alike to spend billions in foreign currencies on a daily basis. Banks too work on an international scale, trading huge amounts of currency every day. For these reasons, the Forex market is the biggest in the world, trading over $5 trillion a day

**Question 3B 10Marks**

**Critically analyze the Federal Budget 2020-21.**

The federal budget for fiscal year (FY) 2020-21, the second one of coalition Government of Pakistan (PTI), announced on June 12, 2020.

Before releasing budget 2020 public and business sector especially from those industries which have exporting had more relief packages expectation from Govt

Whenever budget released some people from govt side appreciate the budget and some people from opposition side get against the budget.

But here as a student of monetary economics I will discuss the budget of 2020

As Hammad Azhar Industries Minister announced the budget PTI Govt didn’t fill full their promise as they promised .

Because there is no any relief for public and also for small and big business also for workers

As the PTI came the business sector going down because of increasing tax and policy changes

PTI govt have no control over hoarding on sugar, flour, and now petrol

They don’t have control over the pricing of basic food poor people are dying because of hunger

And lock down also took their life in danger due to unemployment and no one have that much money to buy a food for them

Corona virus is the new issue which all the world is suffering from but Pakistan financial issue is getting worse before corona virus and as PTI govt came to the power

Recently the sugar and flour hoarding scandal expose but the govt is silent and didn’t take any action to those who are involved

PTI govt also took a huge amount of load in the history of Pakistan and unfortunately it didn’t use over poverty or for useable project

I think the govt should extend the cnic condition and it should be differ to the next year and implement it to the next year budget the govt also focus on the finishing policy

Over all the people had more expectation to this budget bug unfortunately there is no ant big relief package to poor people and also for business sector policies