In The Name Of Allah

The most gracious and
the most merciful

# Monetary Policy

~Syed Ali Roshaan Raza

# Monetary policy:

- Monetary policy is the process by which the monetary authority of a country (usually the central bank) controls the supply of money in the economy in order to control aggregate demand, and promote economic growth and stability.

# Monetary policy:

- The central bank, which has a monopoly over the supply of money usually undertakes this policy.

- It is maintained through actions such as increasing the interest rate, or changing the amount of money banks need to keep in the bank reserves.

# Objectives of monetary policy:

There are basically 3 major objectives:

- To ensure price stability.
- To encourage economic growth.
- To ensure stability of exchange rate of money.

# Objective:

- The goal of monetary policy is to achieve and maintain price-level stability, full employment, and economic growth.

# *What is it used for?*

There are two main reasons why the central bank carries out monetary policy:

- **Expansionary monetary policy**
- **Contractionary monetary policy**

# Expansionary monetary policy

This is when the central bank lowers the interest rates in the economy in order to encourage borrowing and discourage saving.

Aggregate demand increases

Economic Growth

***It is mainly used in a recession.***

# **Contractionary** *or tight* **monetary policy**

This is when the central bank increases the interest rates in the economy in order to reduce the amount of spending.

The purpose is to:

- **decrease the aggregate demand in the economy**

  *(so that prices don't rise too fast)*

- **deal with inflation**

# Tools for monetary policy:

- Open market operations
- Discount rate
- Change in reserve ratio
  - Cash reserve ratio (CRR)
  - Statutory Liquidity requirement (SLR)

# •Open market operations:

The conduct of open market operations refers to the purchase or sale of government securities by the SBP to the banking and non-banking public for liquidity management purposes to keep interest rates in line with its monetary policy objectives.

They are normally short-term operations, carried out when market condition desires.

# •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 specified 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 SBP.

Also referred to as:

- Cash Reserve Ratio (CRR)

  or
- Statutory Liquidity Requirement (SLR)

# Currency in circulation:

Currency that is physically used to conduct transactions between consumers and businesses rather than stored in a bank, financial institution or central bank.

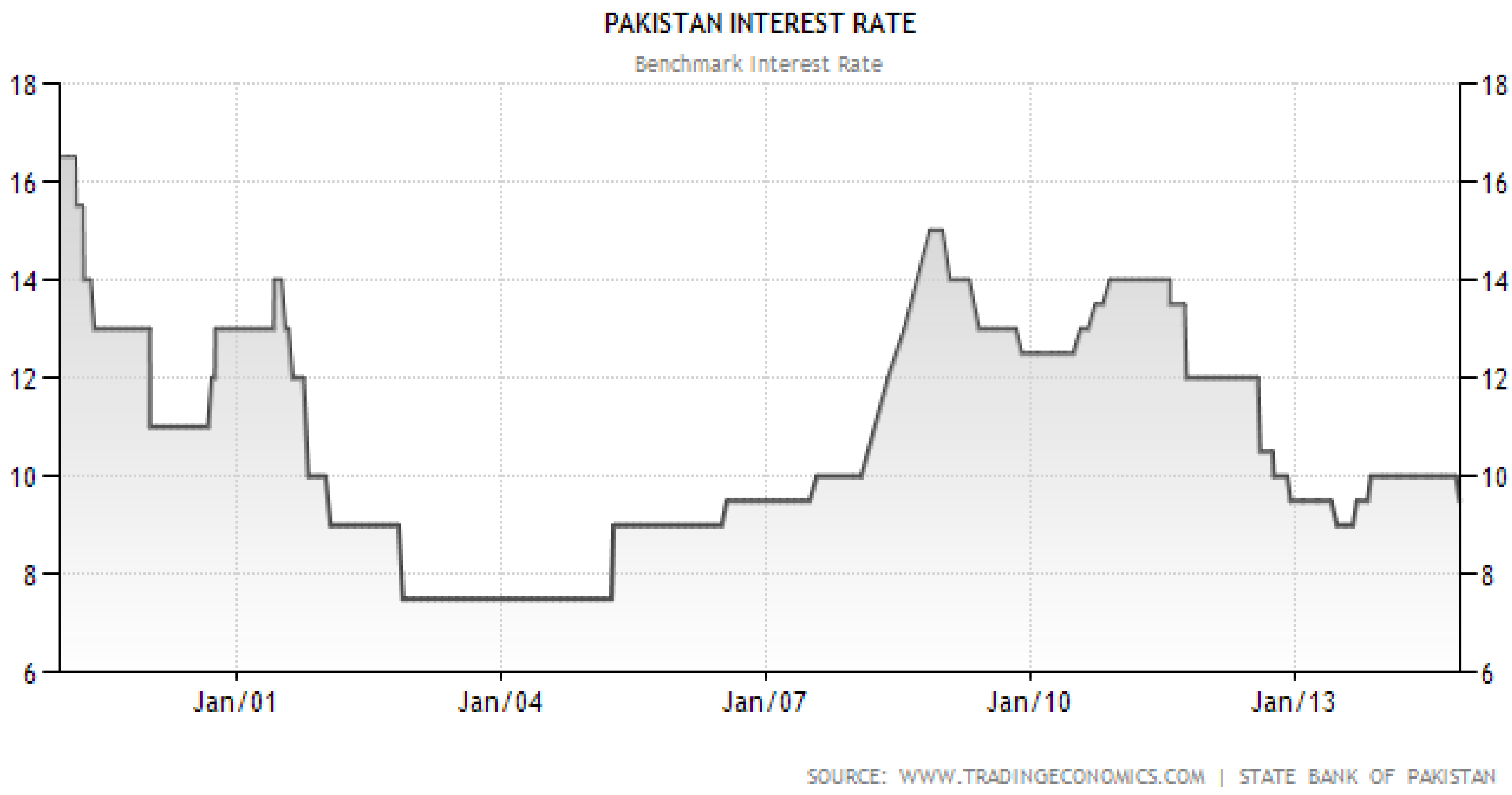
Currency in circulation refers to currency held by public i.e currency *outside* the banking system.

# Monetary policy in Pakistan:

The benchmark interest rate in Pakistan was last recorded at 9.50 percent. Interest Rate in Pakistan averaged 12.55 Percent from 1992 until 2014, reaching an all time high of 20 Percent in October of 1996 and a record low of 7.50 percent in November of 2002.

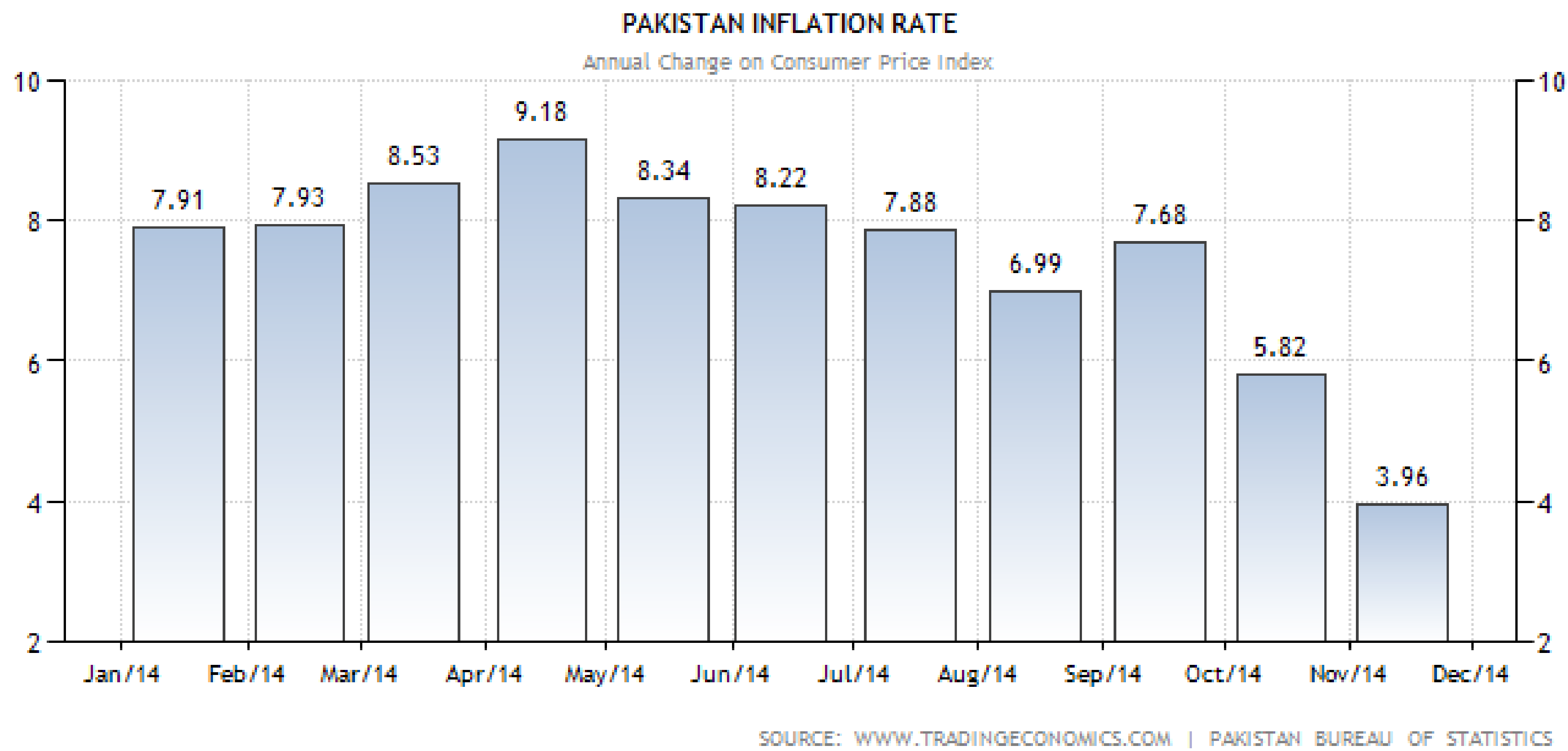
Interest Rate in Pakistan is reported by the State Bank of Pakistan.

# Interest rates in Pakistan for the last 15 years



The State Bank of Pakistan decided to lower the benchmark policy rate by 50 bps to 9.5 percent at its November meeting, citing lower inflation.

Limited impact of floods and a favorable trend in global commodity prices are the major highlights of the post-September monetary policy decision.




Pakistan inflation rate declined to 3.96 % in November of 2014.

It is the lowest rate since October of 2003 due to a fall in prices of transport and fresh food.


Thank you!