

Pinky Rani
Assistant Professor (Guest Faculty)
Department of Economics
Maharaja College
Veer Kunwar Singh University, Ara
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Topic- Monetary Policy

Monetary policy

Monetary policy is a set of tools used by a nation's **central bank** to control the overall money supply and promote economic growth and employ strategies such as revising interest rates and changing bank reserve requirements.

In the United States, the **Federal Reserve Bank** implements monetary policy through a dual mandate to achieve maximum employment while keeping inflation in check.

Monetary policy is a set of actions to control a nation's overall money supply and achieve economic growth.

Monetary policy strategies include revising interest rates and changing bank reserve requirements.

Monetary policy is commonly classified as either expansionary or contractionary.

The Federal Reserve commonly uses three strategies for monetary policy including reserve requirements, the discount rate, and open market operations.

Monetary policy is the control of the quantity of money available in an **economy** and the channels by which new money is supplied.

Economic statistics such as [gross domestic product](#) (GDP), the rate of [inflation](#), and industry and sector-specific growth rates influence monetary policy strategy.

A central bank may revise the interest rates it charges to loan money to the nation's banks. As rates rise or fall, financial institutions adjust rates for their customers such as businesses or home buyers.

Additionally, it may buy or sell government bonds, target [foreign exchange](#) rates, and revise the amount of cash that the banks are required to maintain as reserves.

Types of Monetary Policy

Monetary policies are seen as either expansionary or contractionary depending on the level of growth or stagnation within the economy.

Contractionary

A [contractionary](#) policy increases interest rates and limits the outstanding money supply to slow growth and decrease inflation, where the prices of goods and services in an economy rise and reduce the purchasing power of money. Monetary policy

Expansionary

During times of slowdown or a [recession](#), an [expansionary](#) policy grows economic activity. By lowering interest rates, saving becomes less attractive, and [consumer spending](#) and borrowing increase.

Goals of Monetary Policy

Inflation

Contractionary monetary policy is used to temper inflation and reduce the level of money circulating in the economy. Expansionary monetary policy fosters inflationary pressure and increases the amount of money in circulation.

Unemployment

An expansionary monetary policy decreases unemployment as a higher money supply and attractive interest rates stimulate business activities and expansion of the job market.

Exchange Rates

The exchange rates between domestic and foreign currencies can be affected by monetary policy. With an increase in the money supply, the domestic currency becomes cheaper than its foreign exchange.

Tools of Monetary Policy

Open Market Operations

In **open market operations** (OMO), the Federal Reserve Bank buys bonds from investors or sells additional bonds to investors to change the number of outstanding government securities and money available to the economy as a whole.

The objective of OMOs is to adjust the level of reserve balances to manipulate the short-term interest rates and that affect other interest rates.

Interest Rates

The central bank may change the interest rates or the required **collateral** that it demands. In the U.S., this rate is known as the **discount rate**. Banks will loan more or less freely depending on this interest rate.

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Reserve Requirements

Authorities can manipulate the [reserve requirements](#), the funds that banks must retain as a proportion of the deposits made by their customers to ensure that they can meet their [liabilities](#).

Lowering this reserve requirement releases more capital for the banks to offer loans or buy other assets. Increasing the requirement curtails bank lending and slows growth.