MONETARY POLICY

What is Monetary Policy?

Monetary Policy: Federal Reserve

- ***Controlling the economy through increasing or decreasing the money supply.***
- Two Types of Monetary strategy:
  1) **Tight Money:** taking **money out** of the economy *(decrease money supply)*
  2) **Easy Money:** putting **more money in** the economy *(increase money supply)*

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WHAT IS MONETARY POLICY?

- It is the process by which the monetary authority of the country controls the supply of money.

Objectives of monetary policy

1. Full employment:- Full employment refers to a situation where in all persons who are able to work and willing to work at the prevailing rate of wage, get work. For this purpose government adopts cheap monetary policy in order to raise the level of demand and output substantially. Under cheap money policy, in order to expand the availability of credit, rate of interest is lowered.

2. Economic growth:- Economic growth means sustained rise in real income per capita,. In underdeveloped countries, income and standard of living of people is low. This is further due to low production capacity and low capital formation so government adopts such monetary policy which can accelerate the growth of economy.

3. Price stability:- Price stability means control of wide fluctuations in the general price level in the economy. There can be inflation or deflation in the economy due to market fluctuations.

4. Exchange stability:- It is another objective of monetary policy. This can be attained through the stability of balance of payment and monetary policy seeks to regulate foreign exchange reserves in a manner that imparts stability to supply and demand.

5. Reduction in Economic inequality:- There is wide difference between rich and poor class. With the help of monetary policy government can achieve the goal of equitable distribution of income and wealth through fast delivery of credit facility to poor section of society.

Targets of monetary policy

There are three targets:-
(i)Supply of money
(ii) Cost of money
(iii)Availability of money

Targets

Supply of money	Cost of money	Availability of money
Currency is used by the authority and the demand deposits with the commercial banks.	Cheap money policy in agriculture and industrial section. Rate of interest should be raised during inflation and lowered during depression.	The availability of money is defined as the ease with which, at any given rate of interest money can be borrowed from financial institutions.

Monetary policy instruments

Quantitative instruments	Qualitative instruments
1. Bank rate:- It is the rate of interest which a central bank charges on the loans and advances to a commercial bank. When bank rate is raised, there is contraction of credit, and vice-versa. **2. Open market operations**:- Open market operations refer to the building and selling of government securities in the open market in order to expand or contract the amount of money in the banking system. **3.change in minimum reserve fund**:- Commercial banks are required to keep a given percentage of their total deposits as cash reserve with the central bank. If bank wants to contract credit, it raises the cash reserve ratio, on the other hand when central bank wants to expand credit, it lowers the cash reserve ratio. **4. Change in liquidity ratio**:- Every bank is required to keep a given proportion of its total assets in the form of liquid assets. It is called liquidity ratio when the central bank wants to contract credit, it raises the liquidity ratio and vice-versa.	**1. Change in margin requirement of loans**:- When the central bank feels that the traders are stock piling certain goods as a result of which their prices are rising, then it controls the availability of credit for these goods by changing margin requirement. It means the value of goods pledged as security and the amount of loan is increased. If margin requirement is increased there will be contraction of credit and vice-versa. **3. Rationing of credit**:- Rationing of credit can have any of the four variants. (i)The central bank can decline loan to a specified category of commercial banks. (ii) The central bank can reduce the quantum of loans for all the banks. (iii) Central banks can fix credit quota for different banks (iv) Central bank can determine the limit of credit granted to industry and trade. **4. Direct action**:- Sometimes the central bank may initiate direct action against the commercial banks defying its directions. The central bank may impose strict restriction on the functioning of defaulting bank including denial of loans.

CONCLUSION

Monetary policy is a very effective and useful instrument in achieving the objectives of economic stabilization and economic development. It is a very important part of macroeconomic policy. Nowadays all most all the countries in the world are using this policy for achieving different objectives.

<u>MARKET FORMS</u>

WHAT IS A MARKET?

ANS. The term market refers not necessarily to a place but always to a commodity and the buyers and the sellers who are in direct competition with one another.

<u>Main features of the market:-</u>

FEATURES	EXPLANATION
(i)FEATURE AREA	THE ENTIRE AREA OVER WHICH BUYERS AND SELLERS ARE SPREAD.
(ii)BUYERS AND SELLERS	BOTH ARE NEEDED FOR THE MARKET. THEY CAN ESTABLISH CONTACT WITH EACH OTHER ON MOBILE ETC.
(iii)ONE COMMODITY	EVERY COMMODITY HAS ITS OWN MARKET.
(iv)FREE COMPETITION	THERE SHOULD BE FREE COMPETITION BETWEEN BUYERS AND SELLERS. THERE WILL BE ONE PRICE FOR ONE COMMODITY THROUGHOUT THE MARKET.

<u>Main forms of market structure</u>

Types of market

- **PERFECT COMPETITION**
- **IMPERFECT COMPETITION**
- **MONOPOLY**

<u>IMPERFECT COMPETITION</u> FURTHER INCLUDES -

(i) MONOPOLISTIC COMPETITION
(ii) OLIGOPOLY
(iii)DUOPOLY

1.**Perfect competition**:- Perfect competition is a market in which there are many firms selling identical products with no firm large enough relative to the entire market to be able to influence market price.

MAIN FEATURES

(i)Large number of buyers and sellers
(ii) Homogenous products
(iii) Free entry and exit of the firms
(iv) Perfect knowledge
(v) Perfect mobility
(vi) Lack of selling costs
(v) Absence of transport costs

2. Monopoly:- Monopoly is a market situation in which there is a single seller of a product.

FEATURES

(i)One seller and large no of buyers
(ii) Monopoly firm is also an industry
(iii) Restriction on the entry of new firms
(iv)No close substitutes
(v) Price maker
(vi) Price determination

3. Imperfect competition:- Imperfect competition is the real situation of the market. If the market is unorganized and contact between the buyers and sellers is established with great difficulty and they are not in a position to compare the goods and prices paid, then we face the situation of imperfect competition.

Imperfect completion includes

(i)Oligopoly:- Where in the sellers are few in number.

(ii)Duopoly:- Where there are only two sellers.

3. Monopolistic competition:- It is a market in which there are large number of buyers and sellers and there is product differentiation.

FEATURES

(i)Large no of buyers and sellers
(ii) Freedom of entry and exit of firms
(ii) Product differentiation

- **Selling costs**
- **Partial control over price determination**
- **Imperfect knowledge**
- **Non price competition**

4. Oligopoly:- It is a market in which there are few big producers of the product**.**

FEATURES

(i)Few big sellers and many buyers
(ii) Homogeneous products
(iii) Mutual interdependence
(iv) Lack of uniformity
(v) Existence of price rigidity
(vi)Some parries to entry

Difference between perfect competition monopolistic competition and monopoly markets:-

DIFFERENCE	PERFECT COMPETITION	MONOPOLISTIC COMPETITION	MONOPLY
(i)Number of barriers	LARGE	LARGE	ONE
(ii)Product	HOMOGENOUS	PRODUCT DIFFERENTIATION	HOMOGENOUS AND DIFFERENTIATED
(iii)Entry of firms	FREE ENTRY	NO ABSOLUTE FREEDOM	NOT POSSIBLE
(iv)Knowledge of market conditions	PERFECT KNOWLEDGE	IMPERFECT KNOWLEDGE	IMPERFECT KNOWLEDGE
(v)Selling cost	NOT REQUIRED	VERY SIGNIFICANT	SELDOM
(vi)Transport costs	NIL	INCURRED	INCURRED
(vii)Average and marginal revenue	AR=MR	AR>MR	AR>MR
(viii)Demand curve of firm	PERFECTLY ELASTIC	RELATIVELY MORE ELASTIC	RELATIVELY LESS ELASTIC
(ix)Mobility	PERFECT	IMPERFECT	IMPERFECT