Macroeconomic Overview and Money Contraction Policy

Goals, structure and implementation of the policy.

The government through the federal bank controls the nation`s economy depending on prevailing economic conditions. Therefore, the federal bank might adopt different policies designed to sustain the country`s economy. Among the policies adaptable by the government to regulate specific macroeconomic components is the regulation of the supply of money. This economic neutralization strategy is usually initiated by the federal bank to banks and financial institutions that in turn complete the ripple effect directly onto consumers, the citizens. The need to regulate circulating cash is due to factors such as inflation that may arise when citizens have too much spending power. Therefore, reducing the money in circulation reduces the expenditure of citizens due to the reduction in money. This then creates a financial and economic balance as the demand for products reduces due to reduced spending power (Cob ham, 2015). Reducing the supply of money can be done through different techniques by the federal bank. Firstly, the federal bank reserves can be increased which will force subsidiary financial institutions to increase their respective deposits in the federal bank, therefore, reducing the lending ability of the banks. Also, increased interest rates on loans will discourage citizens from borrowing which will, in turn, minimize expenditure.

Cory Kanth: nice terminology

Issues affected by the policy and debates arising from the policy

The selected country is the United States due the transparency in the Federal Reserve activities. Analyzing USA`s monetary policies, in particular, trimming the amount of money in circulation. The industry affected directly by such moves by the Federal Reserve is credit unions and financial institutions. The credit industry is directly affected by modifications and alterations

in America`s monetary policies. The credit industry is driven by the Federal Reserve and is a very significant monetary tool for the federal government to regulate certain factors of the macro-environment. Therefore, when the Federal Reserve increases the lending rate, financial institutions are required to relay the interest charges to their clients. In a market that is unstable and is nearing inflation, it is important for the government to step in and modify certain policies to restore parity in the crucial sector.

Decreasing lending rate means that market prices can stabilize as consumer might is reduced while producer's capability is compromised as well. This move is important in maintain currency value and ensuring that previously inflated prices are deflated, and normalcy returns to the consumer market (Cob ham, 2015). Also, market behavior and activities can be regulated through declining growth rate of money. Furthermore, the reduction of money in circulation leads to reduction in employment activities on a downscale note since previously created opportunities in the period of inflation are distinguished. The reduction of money supplies ensures the government regulates its economy for it to function at its optimum level.

The effect of implementing the policy is usually felt immediately in the environment. This is because spending power decreases in all sectors and the ability of lenders to issue out loans is compromised due to reduced cash reserves and increased interest rates. The direct effect is then felt by investors and consumers. The move is often controversial and requires maximum concentration and efficiency in implementation to prevent an economic slump that would see a further decline in economic activities. However, the US has consistently been a keen modifier of its monetary policies and reserve rates are usually kept at specific levels depending on the size of institutions. For instance, the US in 2015 modified their monetary policy such that small credit institutions with net limited transactions up to accounts of $14.5 million exempted from the

maintenance of a mandatory reserve. Similarly, accounts ranging from $14.5 million to $103.5 million are required to set aside an incredible 3% of liabilities as required reserve. Further, institutions operating on a higher depository range than $ 103.6 million must satisfy the 10% reserve requirement.

Cory Kanth: You need to offer citations for information like this, and offer a brief explanation as to why.

New Keynesian view of the policy.

The new Keynesian school of thought builds up on previous criticism of the Keynesian model. The New Keynesian faithful hold that citizen wages may be sticky downward in the event of a recession. Therefore, the new Keynesian will perceive the monetary policy to reduce the supply of money as though it has no effect on employment rates. Instead, the theory holds that the fear of loss of jobs will lead to reduced spending and as a result more saving due to job insecurity ("New Keynesian Model and Inflation Prediction", 2013). This move, however, leads to reduced GDP levels in the US. Additionally, Keynesians believe in wage rigidity and as a result, hold that changes in wages are sticky downward which can potentially lead to real unemployment. However, the capacity in the US allows for increases in demand to have a direct impact on real output while minimally affecting the overall price levels.

Cory Kanth: need citation once again

Monetarism view of the policy

The monetarists view the policy as a much required one as the government should aim to control the economy through monetary policies and the central banking system. The school of thought further holds that money supply determines the dollar GDP and price level in the short and long run respectively (Hiraguchi & Kobayashi, 2014). Further, monetarists maintain that markets move towards a center of stability. Therefore inflation is inevitable, but the government can maintain the economy through regulating the flow of cash. Therefore, the reduction in

money supply would lead to a decrease in overall price in the end. However, there would be null effects in consumption and output. Reducing the flow of money will lead to temporary effects on employment and GDP in the short run since wages and prices are sticky (Hiraguchi & Kobayashi, 2014). Effects on employment and other activities exports would thus not be immediate in the short run, but temporary poised to shift in the long run.

Neo-classicalist view

The model is based on long-term projections and holds that unpredictable changes in money affect unemployment and the business cycle. Therefore, the view holds that regular changes in monetary changes can only have effects in the short-run while long-run factors are affected by demand for the products (Harrison & Weder, 2009). Therefore, the shortage of money might not have any effect on unemployment on demand due to instances such as stagnation. The GDP is independent of monetary policies enacted by the government in the short-run but can affect the demand for products in the long run (Harrison & Weder, 2009). Therefore, the move to minimize supply of money might not have immediate effects on both exports and imports. But the effect can change over time depending on the rationality of public expectations.

Cory Kanth: How exactly did you make this connection with the previous thought?

Cory Kanth: This is an incomplete sentence.

Difference and similarities in the models

The monetarist model holds on the significance of money control in the economy. Monetarists believe that control the supply of money to citizens is empirical in regulating the economic environment. Keynesian economist, on the other hand, believes in the role of fiscal activities in the government in a bid to change expenditure mentality by increasing demand for goods and services. Neo classical theorists believe in the responsibility of the government as well

Cory Kanth: You need to refine this sentence. Its meaning is not clear.

Cory Kanth: You also need to work on the wording of this sentence.

in transforming economic trends. The model focuses on income distributions and outputs based on rationality.

Cory Kanth: You need to articulate your meaning better. Your meaning is unclear.

Selected school of thought

The monetarist model aligns perfectly with the macroeconomic policy earlier stated. This is due to the monetarist belief and perception of the impact supply of money has on the economy. Reducing flow of money from the monetarist point of view will lead to a variety of changes in the economy whether short run or long run. These changes are imposed by the reduction in citizen economic activities in a bid to minimize the spending rate, inflation, and stagflation. The reduction of borrowing money from both credit facilities and banks determines the amount of money disposable to an individual.

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