Monetary policy

1- Definition of monetary policy:

It can be said that any comprehensive and adequate definition of monetary policy must include a set of the following main factors:

- Procedures and measures taken by the monetary authorities

Procedures are used to control the amount of cash and credit in the economy and thus influence the behavior of banking and non-banking agents

Monetary policy aims to achieve the goals set by the monetary authorities.

2- Types of monetary policy

These types are:**(Taurus, 2011, p. 197)**:

A- Contractionary monetary policy: It aims mainly to treat the inflationary situation that the economy of a country suffers from. Therefore, the goal of monetary policy towards inflation is to limit the creation of monetary instruments, that is, to limit the creation of money and reduce the money supply, and thus limit the spending of individuals and institutions on purchasing goods and services.

B-Expansionary monetary policy: It aims in its entirety to treat the state of stagnation or contraction that the economy is going through, meaning that the real flow is greater than the cash flow. Here, the monetary authority, represented by the central bank, seeks to increase the money supply and thus increase the demand for goods and services.

3-Monetary policy tools:

Monetary policy tools can be divided into quantitative tools, qualitative tools, and other tools. Below are these different tools and an evaluation of the effectiveness and suitability of each of them to achieve the desired goal.

A-Quantitative tools:

These tools aim primarily to influence the volume of bank credit without focusing on the uses to which this credit is directed. These tools include:

- Re-discount rate policy

- Open market operations

- Legal reserve ratio

A.1-Rediscount rate policy:

-Concept:

The rediscount rate is the interest rate charged by the central bank on cash amounts (advances) granted to commercial banks, and the official discount rate represents the minimum interest rate (base rate) on these advances.**(Leroy, 1984, p. 238).**In the event of inflation, the central bank raises the rediscount rate to limit the ability of commercial banks to expand credit with the aim of reducing inflationary conditions. If the central bank follows an expansionary policy, it reduces the rediscount rate in order to allow banks to discount their commercial papers or borrow to expand the granting of credit.

- Effectiveness of the rediscount rate tool

This tool requires certain conditions that must be met in order for it to be applied successfully.

- ✓ This tool assumes the existence of developing money markets to deal in commercial papers, treasury bills, and other short-term credit instruments that the central bank accepts to re-discount or lend against its guarantee.
- ✓ The necessity of commercial banks relying on the central bank to obtain the necessary funds.
- ✓ This tool assumes that commercial banks change interest rates as the rediscount rate (bank rate) changes..
- ✓ Commercial banks may raise interest rates, but this does not entail a decrease in demand for loans, especially in good periods.

A.2- Open market operations:

- The concept

Open market operations are the purchase and sale of securities by the central bank at the financial market level.

In the event that the central bank follows an expansionary monetary policy to get out of an economic recession, it purchases a quantity of securities in order to enable commercial banks to increase their cash reserve capacity and expand lending operations. However, in the event that the central bank follows a contractionary monetary policy, it sells securities from... In order to reduce the cash reserves of commercial banks and thus reduce their ability to grant credit. This leads to a decrease in the money supply, which leads to an increase in the interest rate, which reduces the volume of investment, income and employment..

- Effectiveness of open market operations:

The open market policy is considered effective compared to the discount rate policy due to its characteristics, including:

- Open market operations are in the hands of the central bank to control credit.

The central bank can purchase securities and then sell them within a short period, in addition to carrying out the repurchase process. This makes it have great flexibility to control credit, and thus control the money supply in a short period.

However, the success of the open market policy depends on the extent to which there are sufficient securities in the market that allow the central bank to influence the market in the event of buying or selling.

A.3- Legal reserve ratio:

- The concept

The Central Bank requires commercial banks to form mandatory reserves in the form of a percentage of customer deposits (this pool includes deposits under consideration, time deposits...). These compulsory reserves are assets (rewarded approximately at the money market rate) in accounts with the central bank. These reserves have two primary goals: to secure the liquidity of the Commercial Bank in order to confront withdrawals from customer deposits (or refinancing difficulties), and the second goal is to organize and control the monetary supply.**(Szpiro, 2009, p. 188)**

In the event of a recession, the central bank reduces the mandatory reserve rate, so reserves increase available to commercial banks, and thus their ability to grant credit increases. However, in the case of inflation, it raises the mandatory reserve rate and the reserves held by commercial banks decrease, which means a decrease in their ability to grant credit, and the volume of credit, employment rate, and demand decrease, and prices decrease.

- Effectiveness of the legal reserve policy:

The legal reserve tool is one of the successful policies in periods of inflation, given that commercial banks do not find itA means of responding to the instructions of the Central Bank within the specified period to raise the cash reserve except by reducing loans, investment volume, and deposits, and vice versa in the case of a recession because the ability of banks to create credit

The increase in the volume of loans is not matched by demand for these loans from individuals and institutions due to the spreadDepression. On the other hand, this tool is not considered flexible because it treats small and large banks equally, as well as banks that have reserves. Despite this, this tool remains more effective and less expensive compared to the two previous monetary policy tools (discount rate and open market), especially in developing countries that do not have markets. Extensive financial and monetary**(Key, 2005, pp. 154-155)**.

B- Qualitative Tools:

These tools aim primarily to influence the type of credit, that is, the way it is used, and not the total volume of credit.. These tools include:

- Loan framing policy

- Selective loan policy

B.1- Loan framing policy:

This tool seeks to determine the value or maximum growth rate of loans that banks can grant to the public. According to the principle, this limit (maximum rate) is fixed directly relative to the assets (receivables) held by the banks and also the banks' liabilities (deposits), and thus this procedure is considered a directive by the Central Bank.**(Rossi, Macroeconomic history and politics, 2008, p. 247)**

B.2- Selective loan policy

This tool relates to some sectors thatThe Central Bank considers it more profitable for the national economy by directing loans to it, so that its decisions are sufficient to give all facilities in granting loans to these sectors, and the primary goal of using this tool is to influence the direction of loans towards the economic sectors and desired uses.

C- Other tools of monetary policy

C.1-Literary persuasion:

The Central Bank works to persuade commercial banks to follow policies consistent with the goals it aims to achieve. This moral influence or persuasion may take the form of statements made by the central bank, or directives and advice it gives to banks regarding the policies it pursues in conducting their activities, or conferences to which bank managers are called to exchange opinions and review various points of view. **(Al-Foley, 2003, pp. 159-160)**

C.2-Directions and orders:

One of the responsibilities of the Central Bank is to issue direct instructions to commercial banks and financial institutions to direct them to the desired policies based on the volume and nature of credit, such as the Central Bank using part of the financial assets of commercial banks to purchase government bonds or lending them to owners of long-term investment projects. The Central Bank also undertakes By determining the ratio that banks must consider between capital, reserves, and their total assets, or imposing a maximum limit on the total of banks' loans and investments for certain types.**(Daas, 2007, pp. 184-185)**

C.3- Direct inspections of bank operations:

The Central Bank conducts direct inspection of bank operations on a regular basis (monthly, semi-annually, or annually) as needed to determine the extent to which the banks are implementing the instructions and orders directed to them by the Central Bank. The Central Bank also receives reports on the banks' annual activities that show the status of the banks and their liquidity. The volume of deposits and loans...etc**(Moftah, 2005, p. 160)**

Therefore, it can be said that the Central Bank does not depend, in achieving its objectives, on one method of credit control, but rather uses at the same time various methods and methods of supervision that enable it to achieve the objectives it aims to achieve.