Monetary Policy Transmission

In addition to the Monetary Policy Transmission video, you will find hereafter the text of this video as well as the mind map concluding the video.

The primary objective of monetary policy is price stability. The central bank has various tools to achieve this. The most traditional tool is **key policy rates :** the interest rates the central bank charges for its loans to commercial banks.

To curb inflation, the central bank increases its key policy rates. If it wants prices to rise, it lowers the policy rates.

But how is the central bank's decision transmitted to the economy? The mechanisms that intervene between the central bank's actions and their effects on prices are called "**monetary policy transmission**" mechanisms. There are 4 "**transmission channels**".

THE INTEREST RATES CHANNEL

The **interest rates channel** can affect the economy's interest rates, particularly bank loan rates. When the central bank increases its key policy rates, commercial banks reflect this increase in the interest rates on loans granted to their customers. As borrowing costs increase, economic actors borrow less, restricting consumption and investments. Economic activity slows down, and inflation decreases.

THE EXPECTATIONS CHANNEL

The **expectations channel** allows companies and households, thanks to clear and credible action by the central bank, to anticipate future evolutions of interest rates accurately and adapt their economic decisions accordingly.

THE ASSET PRICE CHANNEL

The **asset price channel** consists of the effect of a change in interest rates on the price of certain assets. For example, a lower policy rate makes financial products whose evolution is linked to interest rates — such as bonds — less attractive. Investors will therefore find alternative assets, like shares, which will then rise in price. Holders of this type of financial investment will see their wealth increase, pushing them to increase consumption.

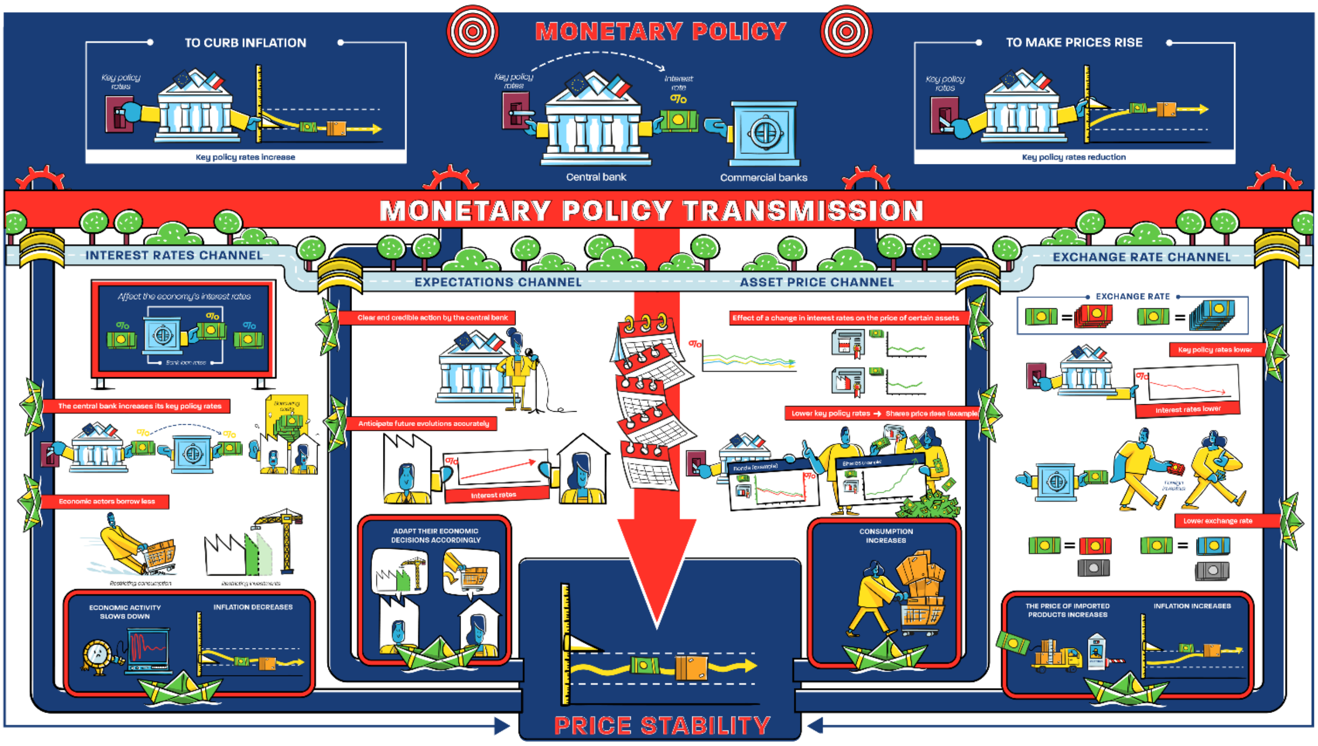
THE EXCHANGE RATE CHANNEL

Finally, monetary policy can be transmitted by using the **exchange rate channel**. An exchange rate is the price of a currency relative to foreign currencies. When the key policy rates, and consequently interest rates, have lowered, deposits in that currency become less attractive for foreign investors, resulting in a lower exchange rate. The price of imported products, therefore, increases, which tends to increase inflation.

TRANSMISSIONS DELAYS

The transmission of monetary policy to the economy via these four channels may take several months. As a result of these "**transmissions delays**", the central bank must conduct its policy over the medium term.

MIND MAP CONCLUDING THE VIDEO



This ABC de l'économie video was made with the Sydo communication agency.

Please find [here the same video in French](#).