INTERNATIONAL JOURNAL OF FINANCIAL ECONOMICS (IJEFE) e-ISSN: 3063-3648
Vol. 1 No. 3 September 2024, page 703-710

THE EFFECTIVENESS OF MONETARY POLICY IN DEALING WITH ECONOMIC CRISIS: A LITERATURE REVIEW

H. Mohdari *[1]
STIE Nasional Banjarmasin
mohdaribjm@gmail.com

Selvanus
STIE Dahani Dahanai
selvanus19@gmail.com

Lydia Goenadhi
STIE Indonesia Banjarmasin
lydia@stiei-kayutangi-bjm.ac.id

Abstract
Economic crises force policymakers to employ various monetary policy instruments in order to lessen the effects. In this research paper, literature research method is utilized. Results demonstrate how monetary policy (in the form of interest rate cuts, quantitative easing and open market operations) has been utilized to increase liquidity in markets, stabilize the financial system and support economic growth even during periods of recession. Monetary policy success relies upon its swift implementation, relevant measures, and economic conditions prevailing at that moment. While non-traditional monetary policies adopted during the economic crisis have had positive results, they also come with risks and side effects including potential long-term inflation and asset bubble formation. Therefore, conclusions draw indicate the need for closer coordination between monetary and fiscal policies as well as adaption of a sustainable approach for meeting future challenges to economic health.
Keywords: Effectiveness, Monetary Policy, Economic Crisis.

Introduction

Monetary policy is one of the primary tools used by governments and central banks to shape the economy. It involves setting interest rates, buying or selling government bonds, and altering money supply in order to achieve various economic targets - such as inflation control, unemployment reduction and greater financial stability (Grenville & Rajah, 2021). Monetary policy becomes especially crucial during times of economic crises due to internal or external causes like stock market crashes, banking crises or shocks from political situations or natural disasters (Hodson, 2020).

Economic crises often lead to lasting and severe losses for economies, including high unemployment rates, income reduction and even business collapse. Under such conditions, effective monetary policy becomes vital since decisions taken by

[1] Correspondence author

policymakers may either accelerate recovery or worsen economic conditions further (Wullweber, 2024).

Monetary policy plays a vital role in modern economies, serving as an invaluable instrument used by central banks and governments to control inflation, promote economic growth and decrease unemployment. Monetary policy becomes even more influential during times of economic turmoil; by setting interest rates or conducting open market operations and setting bank reserve requirements policymakers can alter the amount of liquidity in an economy's system and thus impact consumption and investment decisions (Fernández et al., 2021).

During a crisis, monetary policy assumes an even more pivotal role as it serves to alleviate uncertainties and stressors that emerge. Economic crises typically lead to declining aggregate demand, production decline, investment halt and increasing unemployment rates - all indicators of weakness for an economy. Monetary policy's primary function can be used as an effective stimulus tool by lowering interest rates which makes borrowing more affordable for firms and individuals, thus encouraging higher spending and investment that ultimately results in economic revival (Weiping, 2023).

However, the implementation of monetary policy during a crisis also presents several difficulties. Its effectiveness may be limited by a liquidity trap where interest rates near zero cannot be further reduced to stimulate the economy (Waheed & Rashid, 2021). Furthermore, coordination with fiscal policy and centrality of monetary policy for price stability and the overall economy is of great importance; hence an appropriate and well-thought out response from monetary policy must help mitigate impact and spur sustainable recovery of an economic crisis; central banks and policymakers need to collaborate closely in utilizing various forms of policy tools in order to achieve effective economic recovery of their economy (Schaffartzik & Duro, 2022).

Monetary policy plays a key role in controlling and mitigating economic crises. How these policies are created and implemented has an effect not only on local recovery efforts but also on global economies (Markakis, 2020).

Thus, this research seeks to examine monetary policies of countries in order to overcome economic crises.

Research Methods

The study in this research uses the literature research method. The literature research method is one of the explorative and systematic research methods in collecting, reviewing, and analysing available sources to answer specific research questions, build scholarship, or develop a theoretical framework in a field of study. This method relies on written publication data, such as books, journal articles, theses, and online sources, to explore existing information and draw conclusions based on existing literature (Firman, 2018); (Suyitno, 2021).

Results and Discussion

Monetary Policy During the Crisis

Monetary policy refers to actions taken by central banks of different nations - like Bank Indonesia in Indonesia or the Federal Reserve in America or European Central Bank in Europe - to control money supply and interest rates with the goal of stabilising prices and achieving sustainable economic growth (Zainuddin & Hasanah, 2020). Monetary policy implementation techniques may include interest rate adjustments, open market operations or changes in cash reserve ratios in order to regulate liquidity in an economy, influence exchange rates or inflation levels and employment prospects - ultimately creating ideal economic conditions that support financial stability and growth (Hassen & Hamdi, 2020).

Monetary policy refers to an array of instruments and measures deployed by central banks to achieve macroeconomic stability. Policies such as these include adjustments to the base lending rate which affect all interest rates throughout the economy, open market operations to buy or sell securities to regulate money supply, as well as setting minimum reserve ratios that commercial banks are required to adhere to for safe bank liquidity. Monetary policy involves not only discount facilities and lending facilities as a form of support for banks in emergencies; central banks also use these elements of monetary policy to influence inflation rates, economic growth and banking sector stability - all key elements to the health of an economy (Booth & Booth, 2020).

Central banks around the world generally use expansionary monetary policies during periods of economic turmoil to mitigate its impact. This typically includes reducing interest rates to extremely low levels in order to ease access to loans for individuals and businesses alike, increasing spending and investment as a result. Furthermore, central banks can increase market liquidity via open market operations by purchasing financial assets like government bonds or securities in an attempt to pump money into the economy and promote spending and investment while stabilising financial markets (Liu, 2023).

Central banks often resort to unconventional measures when conventional approaches are insufficiently effective, including quantitative easing. This strategy involves large purchases of financial assets by central banks in order to increase monetary base and decrease yields on long-term bonds in order to lower lending rates and increase market liquidity. Additionally, central banks can also provide emergency lending facilities to banks experiencing liquidity issues so as to avert further economic turmoil from taking place (Ozili, 2024).

Forward guidance policy implementation is another strategy used by central banks during times of economic distress, wherein they offer public guidance or expectations regarding future monetary policy directions in order to manage market expectations and influence long-term economic behavior. Forward guidance also offers

certainty regarding their commitment to maintaining low interest rates over an extended period or until certain economic targets such as inflation and unemployment levels have been reached (Souza, 2024).

Conclusion In general, monetary policy during an economic crisis consists of providing sufficient liquidity, lowering interest rates and maintaining the normal functioning of financial markets. Central banks use both conventional and unconventional instruments - from interest rate cuts and open market operations to quantitative easing and forward guidance - to meet their goals. A flexible yet responsive monetary policy is critical for mitigating negative effects of crisis on economy while speeding recovery efforts.

Economic Crisis

An economic crisis occurs when a country or region experiences a sharp decrease in multiple key aspects, such as gross domestic product (GDP), currency value or bankruptcies of companies and banks. Economic crises often manifest with high unemployment rates, declining investment, tightening credit, loss of trust from economic actors, consumption declines and production decreases that lead to large-scale declines. Such situations often call for government intervention for stabilization and recovery purposes (Fernández et al., 2021).

Economic crises can be divided into various categories depending on their causes and characteristics. One such crisis type is financial crises, in which asset values decline dramatically due to market turmoil, investor panic or burst of speculative bubbles. Banking crises often occur as depositors withdraw funds in droves that result in bank failure; currency crises also frequently happen when currency exchange rates plummet due to balance of payments deficits or foreign investors losing confidence with one of its currency pairs (Francis et al., 2020).

Debt crises such as those experienced during the Eurozone debt crisis, where countries are unable to pay back or refinance their debts without external assistance, is another type of economic crisis, but often comes together with debt crises for an escalating spiral of crises that governments and international financial institutions struggle to manage effectively (Markakis, 2020). An economic crisis may also involve broad systemic effects like those experienced during Great Depression in 1930s or Global Financial Crisis of 2007-2008 - these can often occur simultaneously or quickly after each other, creating multiple obstacles and challenges when managing such events effectively (Lee, 2021).

Economic crises can stem from various sources, often including internal and external forces which undermine a country's financial health. Internally, one of the primary factors may be unsustainable economic policies that exacerbate existing deficits and debt loads - for instance excessive public spending without adequate

revenue support can quickly create deficits that lead to major budget gaps and debt accumulation (Zaytsev, 2020). Additionally, instability in the banking sector due to imprudent lending or failures in financial regulation can trigger a banking crisis that then spirals into a wider financial crisis. Asset bubbles often contribute to this scenario when asset prices such as stocks or real estate experience rapid increases due to excessive speculation that leads to their subsequent collapse, harming economies worldwide (Tuori, 2020).

On the external front, global economic shocks such as commodity price drops, exchange rate fluctuations or political unrest in major trading partner nations may spark a crisis. Due to international trade and financial flows, an economic crisis in one country or region may quickly spread through international trade and finance flows to others around the globe. Other contributing factors may include changes in major economies that affect global capital flows like interest rate hikes by major central banks that force investors out of emerging markets; such combination often contributes to an economic crisis (Mattos, 2022).

Additionally, it is crucial to recognise that economic crises often go well beyond financial sector concerns, affecting real economy activity such as production, investment and consumption in tangible ways. Soaring unemployment rates and income losses among households often exacerbate socioeconomic conditions further and become difficult to overcome without coordinated policy interventions from governments and international financial institutions such as fiscal stimulus measures, liquidity support for banking systems, structural reforms or debt restructuring - among many others (Caldara et al., 2021).

Economic crises are complex phenomena caused by multiple internal and external forces, with far-reaching and diverse impacts. Effective anticipation and risk management - such as prudent macroeconomic policies, stringent financial regulation and international co-operation - is vital in both preventing and responding to crises. Longer term, resilient and inclusive economic systems capable of withstanding shocks should be built across nations as a priority; economic stability awareness must continually adapt with evolving global dynamics.

Comparison of Monetary Policy between Countries

Monetary policy is one of the primary tools central banks use to manage economies globally, though approaches and strategies used may vary greatly depending on individual country economic conditions, policy frameworks, and objectives. For instance, the Federal Reserve in the US prioritizes controlling inflation through interest rate setting and open market operations while in Europe their European Central Bank (ECB) prioritizes price stability through asset purchase programs alongside using interest rates as their main instrument for doing so (Neely et al., 2020).

As developing countries are particularly susceptible to capital flows and external shocks, their central banks may need to intervene more frequently in foreign exchange markets to maintain currency stability. On the other hand, advanced countries such as Japan's Bank of Japan has taken an aggressive stance toward loose monetary policy implementation (known as quantitative and qualitative easing) for decades now in order to combat deflation and promote economic growth (Kokores, 2023).

Domestic dynamics also play a vital role in shaping a country's monetary policy. Brazil and India, for instance, have used relatively high interest rates to control inflation - often an ongoing challenge in emerging economies due to structural reasons and its affects on large populations. Russia or Saudi Arabia with large commodity production may put more focus on how commodity price fluctuations impact their economies using monetary policy to mitigate any negative repercussions of these shifts in price (Talahite, 2021).

Comparing monetary policies would not be complete without considering global macroeconomic conditions. Recently, challenges like the COVID-19 pandemic have led many central banks to take unconventional measures such as quantitative easing and negative interest rates - as seen by European and Japanese central banks respectively. Responses to crises often require close international collaboration and communication to minimize systemic impacts on the global economy (Nikolayev, 2020). As we transition into post-pandemic recovery periods, central banks face the arduous challenge of scaling back support without undermining growth prospects. These dynamics make comparing global policies even more complex but also vitally important (Shtan, 2020).

Conclusion

Monetary policy has proven itself an invaluable asset in responding to economic crises, as evidenced by various literature reviews. Central bank responses such as interest rate cuts, large-scale asset purchases and providing extraordinary liquidity have often proved successful at stabilising financial markets and stimulating economies alike. Their effectiveness often depends on how quickly and widely implemented as well as upon underlying economic and financial conditions.

Non-traditional monetary policy approaches such as quantitative easing and negative interest rates have shown their ability to boost economic growth during times of extreme uncertainty. Studies have also stressed the need to be vigilant of their potential side effects and risks, including asset bubble formation or any negative effect on financial institutions' profit margins.

Conclusion In conclusion, monetary policy has played an essential role in helping countries overcome recent economic crises by providing the basis for economic recovery and stability. History reveals its effectiveness can be strengthened further when coordinated with fiscal policy and structural reforms that strike a balance between short-term benefits and any long-term consequences. Looking ahead,

policymakers must constantly adapt and evaluate their approaches based on changing economic conditions and growing knowledge.

References

Booth, J. R., & Booth, L. C. (2020). Economic Factors, Monetary Policy, and Expected Returns on Stocks and Bonds. *Handbook of Monetary Policy*, *Query date: 2024-10-04 10:24:18*, 757–769. https://doi.org/10.4324/9780429270949-61

Caldara, D., Gagnon, E., Martínez-García, E., & Neely, C. J. (2021). Monetary Policy and Economic Performance Since the Financial Crisis. *Review*, *103*(4). https://doi.org/10.20955/r.103.425-60

Fernández, M. Á. E., Alonso, S. L. N., Jorge-Vázquez, J., & Forradellas, R. F. R. (2021). Central Banks' Monetary Policy in the Face of the COVID-19 Economic Crisis: Monetary Stimulus and the Emergence of CBDCs. *Sustainability*, *13*(8), 4242–4242. https://doi.org/10.3390/su13084242

Firman, F.-. (2018). *PENELITIAN KUALITATIF DAN KUANTITATIF*. *Query date: 2024-05-25 20:59:55*. https://doi.org/10.31227/osf.io/4nq5e

Francis, N. R., Jackson, L. E., & Owyang, M. T. (2020). How has empirical monetary policy analysis in the U.S. changed after the financial crisis? *Economic Modelling*, *84*(Query date: 2024-10-04 10:24:18), 309–321. https://doi.org/10.1016/j.econmod.2019.04.022

Grenville, S., & Rajah, R. (2021). 3 COVID-19 and monetary policy. *Economic Dimensions of Covid-19 in Indonesia*, *Query date: 2024-10-04 10:24:18*, 24–43. https://doi.org/10.1355/9789814951463-006

Hassen, G., & Hamdi, K. (2020). The impact of monetary policy on overall and sectoral economic growth: Evidence from Tunisian central bank in crisis periods. *International Journal of Monetary Economics and Finance*, *1*(1), 1–1. https://doi.org/10.1504/ijmef.2020.10032357

Hodson, D. (2020). 7. Economic and Monetary Union. *Policy-Making in the European Union*, *Query date: 2024-10-04 10:24:18*, 152–181. https://doi.org/10.1093/hepl/9780198807605.003.0007

Kokores, I. T. (2023). Monetary Policy Crisis in the Eurozone. *Financial and Monetary Policy Studies*, *Query date: 2024-10-04 10:24:18*, 99–136. https://doi.org/10.1007/978-3-031-41958-4_5

Lee, S. (2021). Monetary and fiscal policies in the United States. *Economic Policy and the Covid-19 Crisis*, *Query date: 2024-10-04 10:24:18*, 15–38. https://doi.org/10.4324/9781003153603-3

Liu, W. (2023). Economic Growth, Market-Oriented Reform, and Monetary Policy in China. *Research on China's Monetary Policy System and Conduction Mechanism*, *Query date: 2024-10-04 10:24:18*, 1–20. https://doi.org/10.1007/978-981-19-9060-1_1

Markakis, M. (2020). The Crisis-Induced Developments in the Economic and Monetary Union. *Accountability in the Economic and Monetary Union*, *Query date: 2024-10-04 10:24:18*, 18–65. https://doi.org/10.1093/oso/9780198845263.003.0002

Mattos, O. B. (2022). Monetary policy after the subprime crisis. *Handbook of Economic Stagnation*, *Query date: 2024-10-04 10:24:18*, 341–359. https://doi.org/10.1016/b978-0-12-815898-2.00006-9

Neely, C. J., Martinez-Garcia, E., Gagnon, E., & Caldara, D. (2020). *Monetary Policy and Economic Performance since the Financial Crisis*. *Query date: 2024-10-04 10:24:18*. https://doi.org/10.20955/wp.2020.026

Nikolayev, Y. (2020). MONETARY POLICY IN CRISIS. *Economic Scope*, *Query date: 2024-10-04 10:24:18*. https://doi.org/10.32782/2224-6282/164-2

Ozili, P. K. (2024). *Economic Policy for Sustainable Development: Role of Monetary Policy, Fiscal Policy and Regulatory Policy*. *Query date: 2024-10-04 10:24:18*. https://doi.org/10.2139/ssrn.4900150

Schaffartzik, A., & Duro, J. A. (2022). 'Dematerialization' in times of economic crisis: A regional analysis of the Spanish economy in material and monetary terms. *Resources Policy*, *78*(Query date: 2024-10-04 10:24:18), 102793–102793. https://doi.org/10.1016/j.resourpol.2022.102793

Shtan, M. (2020). MONETARY POLICY IN THE GLOBAL CRISIS OF 2020. *Ekonomika Ta Derzhava*, 6, 98–98. https://doi.org/10.32702/2306-6806.2020.6.98

Souza, L. V. de. (2024). Houses Built on Sand: The "Global Financial Crisis". *A Century of Global Economic Crises*, *Query date: 2024-10-04 10:24:18*, 67–94. https://doi.org/10.1007/978-3-031-53460-7_5

Suyitno. (2021). *METODE PENELITIAN KUALITATIF KONSEP, PRINSIP DAN OPERASIONALNYA*. *Query date: 2024-05-25 20:59:55*. https://doi.org/10.31219/osf.io/auqfr

Talahite, F. (2021). Monetary Policy in Algeria (1999–2019): *Economic and Monetary Sovereignty in 21st Century Africa*, *Query date: 2024-10-04 10:24:18*, 105–128. https://doi.org/10.2307/j.ctv244ssnb.8

Tuori, K. (2020). Monetary Policy (objectives and instruments). *The EU Law of Economic and Monetary Union*, *Query date: 2024-10-04 10:24:18*, 615–698. https://doi.org/10.1093/oso/9780198793748.003.0027

Waheed, F., & Rashid, A. (2021). Credit frictions, fiscal imbalances, monetary policy autonomy, and monetary policy rules. *The Journal of Economic Asymmetries*, *23*(Query date: 2024-10-04 10:24:18). https://doi.org/10.1016/j.jeca.2020.e00192

Weiping, L. (2023). China's Strategic Choices for Monetary Policy and Economic Adjustment. *American Monetary Policy Adjustment and Its Impacts*, *Query date: 2024-10-04 10:24:18*, 279–324. https://doi.org/10.1007/978-981-99-7810-6_10

Wullweber, J. (2024). *Central Bank Capitalism*. *Query date: 2024-10-04 10:24:18*. https://doi.org/10.1515/9781503639638

Zainuddin, A., & Hasanah, J. (2020). East Java Economic Model: Monetary Policy Implications in the Middle of the Covid-19 Crisis. *East Java Economic Journal*, *4*(1), 22–37. https://doi.org/10.53572/ejavec.v4i1.38

Zaytsev, Yu. K. (2020). Monetary and Fiscal Policy Measures during the COVID-19 Economic Crisis in Russia. *Finance: Theory and Practice*, *24*(6), 6–18. https://doi.org/10.26794/2587-5671-2020-24-6-6-18