

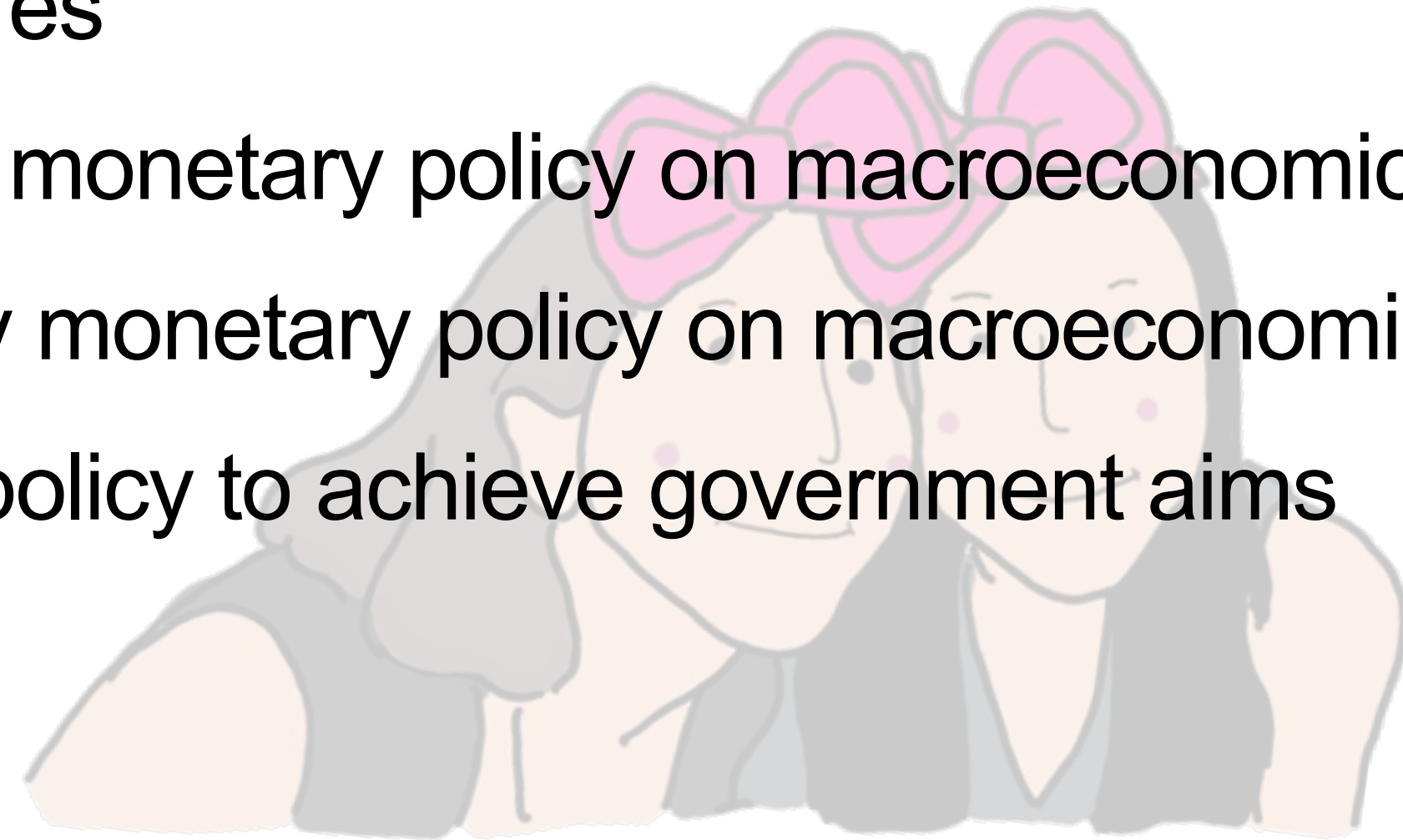


MACROECONOMICS - Monetary policies

By Kru P'Da and Kru P'Eve Knockout.Economics

Overviews

1. Money supply and monetary policy
2. Monetary policy measures
3. Effects of expansionary monetary policy on macroeconomic aims
4. Effects of contractionary monetary policy on macroeconomic aims
5. Summary of monetary policy to achieve government aims



1. Money supply and monetary policy

1.) Money supply

- Money supply is all the money in an economy at any one time including notes, coins and deposit account.

2.) Monetary policy

- Implemented by central bank
- Policies to control AD and inflation rate.
- By changing **money supply**, the **rate of interest** and the **exchange rate** taken to influence aggregate demand.



2. Monetary policy measures

1. Changes in money supply

An increase money supply

- ➔ Central bank *prints money* and *buys government bond* from private sector.
- ➔ People have more money to spend.
- ➔ Commercial banks have more money to make loan.

2. Changes in Interest rate

An increase in interest rate

- Higher return on saving => Save more and spend less => **Consumption** ↓
- Higher cost of borrowing => Borrow less money to invest => **Investment** ↓
- Money inflow to deposit => Demand for the currency ↑ => **Currency appreciation**

2. Changes in Exchange rate

An increase in exchange rate (the currency has higher value)

- ➔ Making *imports become cheaper* in domestic's view
- ➔ Price of imported raw material ↓

3. Monetary policy

Policies to achieve economic aims

Demand-side policy (Policies to influence AD)

Fiscal policy

- By government
- Changes in government spending and tax rate to influence AD

Monetary policy

- By central bank
- Policies to influence AD and to control inflation by changing interest rate & money supply.

Expansionary monetary policies

↑ Money supply, ↓ interest rate

Contractionary monetary policies

↓ Money supply, ↑ interest rate

Supply-side policy (Policies to influence AS)

Supply-side policy

- Policies to increase productive potential of an economy
- e.g. education

3. Effects of expansionary monetary policy on macroeconomic aims

Expansionary monetary policy : Reducing interest rate and increasing money supply to increase aggregate demand.

To increase economic growth by expansionary monetary policy

1. Increasing money supply	<ul style="list-style-type: none">➔ People have more money to spend => consumption↑ => AD↑ => higher production and employment => national income and output↑➔ Commercial banks make more loan => investment↑ => AD↑ => higher production and employment => Economic growth
2. Reducing interest rate	<ul style="list-style-type: none">➔ People spend more money rather than save => consumption↑ => Firms increase production and more workers are being employed.➔ Businesses borrow money to invest => investment↑ => AD↑ => higher production and employment => Economic growth

Limitations of expansionary monetary policy to increase economic growth

1. It depends on **consumer confidence**. If consumers lack of confidence they do not increase spending.
2. **A small cut in interest** may have insignificant effects on motivating economy.

4. Effects of contractionary monetary policy on macroeconomic aims

Contractionary monetary policy : Increasing interest rate and reducing money supply to reduce aggregate demand.

To reduce inflation by contractionary monetary policy

1. Reducing money supply	<p>➔ People buy bond and have less money to spend => consumption ↓ => AD ↓ => lower inflation.</p> <p>➔ Commercial banks have less money to make loan => loan available ↓ => investment ↓ => AD ↓ => lower inflation.</p>
2. Increasing interest rate	<p>➔ People save more money => consumption ↓ => AD ↓ => lower inflation.</p> <p>➔ Businesses do not want to borrow money to invest => investment ↓ => AD ↓ => Lower inflation.</p>

Limitations of contractionary monetary policy to reduce inflation.

1. It depends on **business confidence**. If businesses have high confidence, they still borrow to invest.
2. **A small rise in interest** may have insignificant effects on reducing spending and inflation.

5. Summary of monetary policy to achieve government aims

Monetary policy to achieve government aims	
<u>Expansionary monetary policies:</u> Increasing money supply and reducing interest rate to increase AD	High economic growth
	High employment
<u>Contractionary monetary policies:</u> Reducing money supply and increasing interest rate to reduce AD	Low inflation
	Balance of payment stability

Knockout Economics



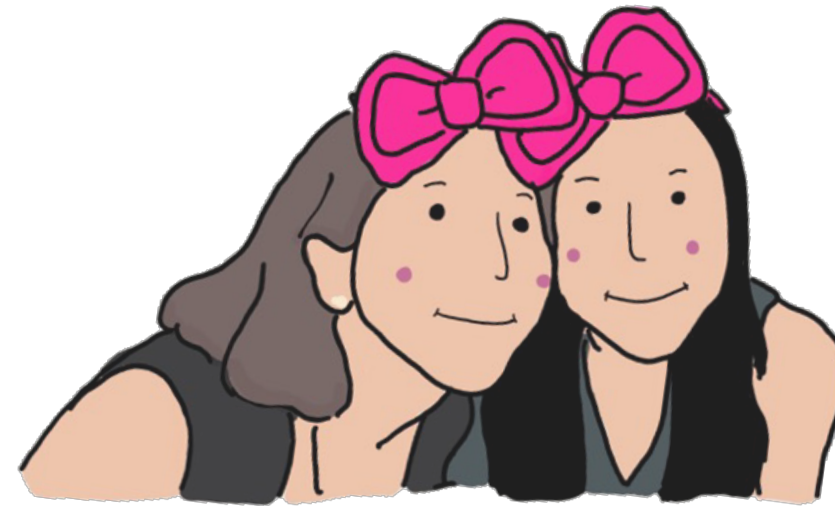
FB PAGE : KNOCKOUT.ECONOMICS



IG : KNOCKOUT.ECONOMICS



YOUTUBE : KNOCKOUT.ECONOMICS



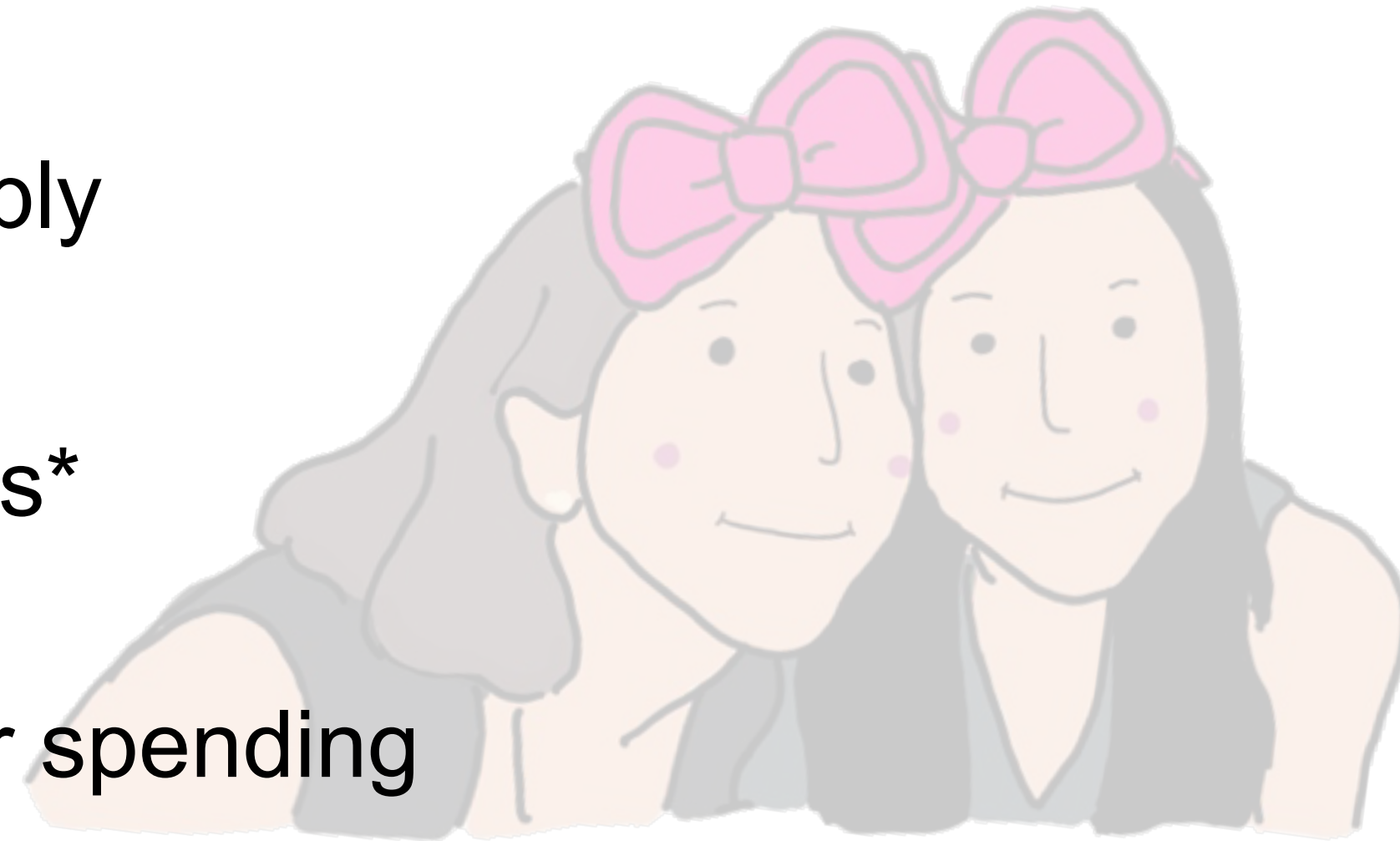
MACROECONOMICS - Exercise : Monetary policy

By Kru P'Da and Kru P'Eve Knockout.Economics

Exercise: MCQ

1.) Which policy is an example of an contractionary monetary policy?

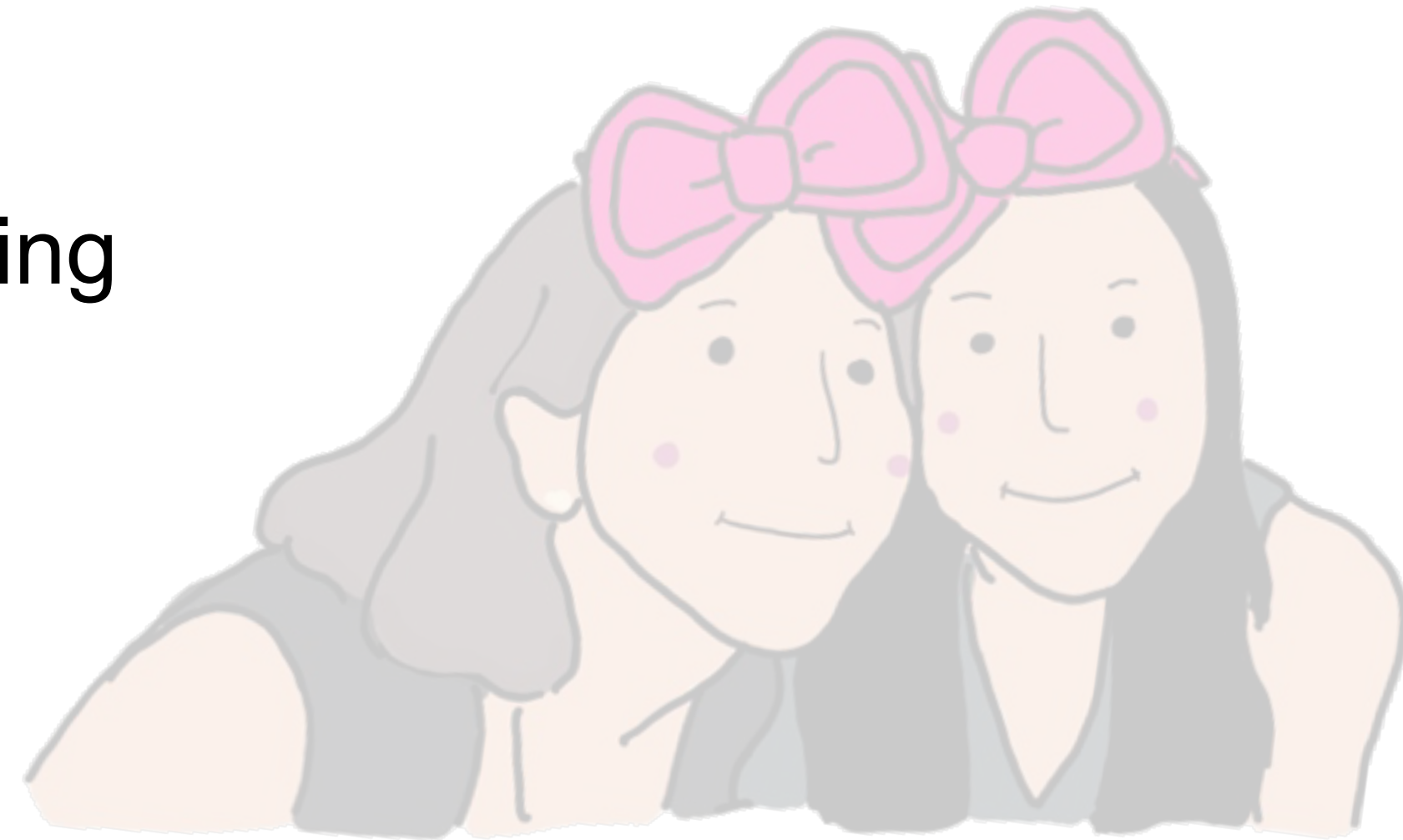
- A. Higher money supply
- B. Higher interest rates*
- C. Lower public sector spending
- D. Higher taxation



Exercise: MCQ

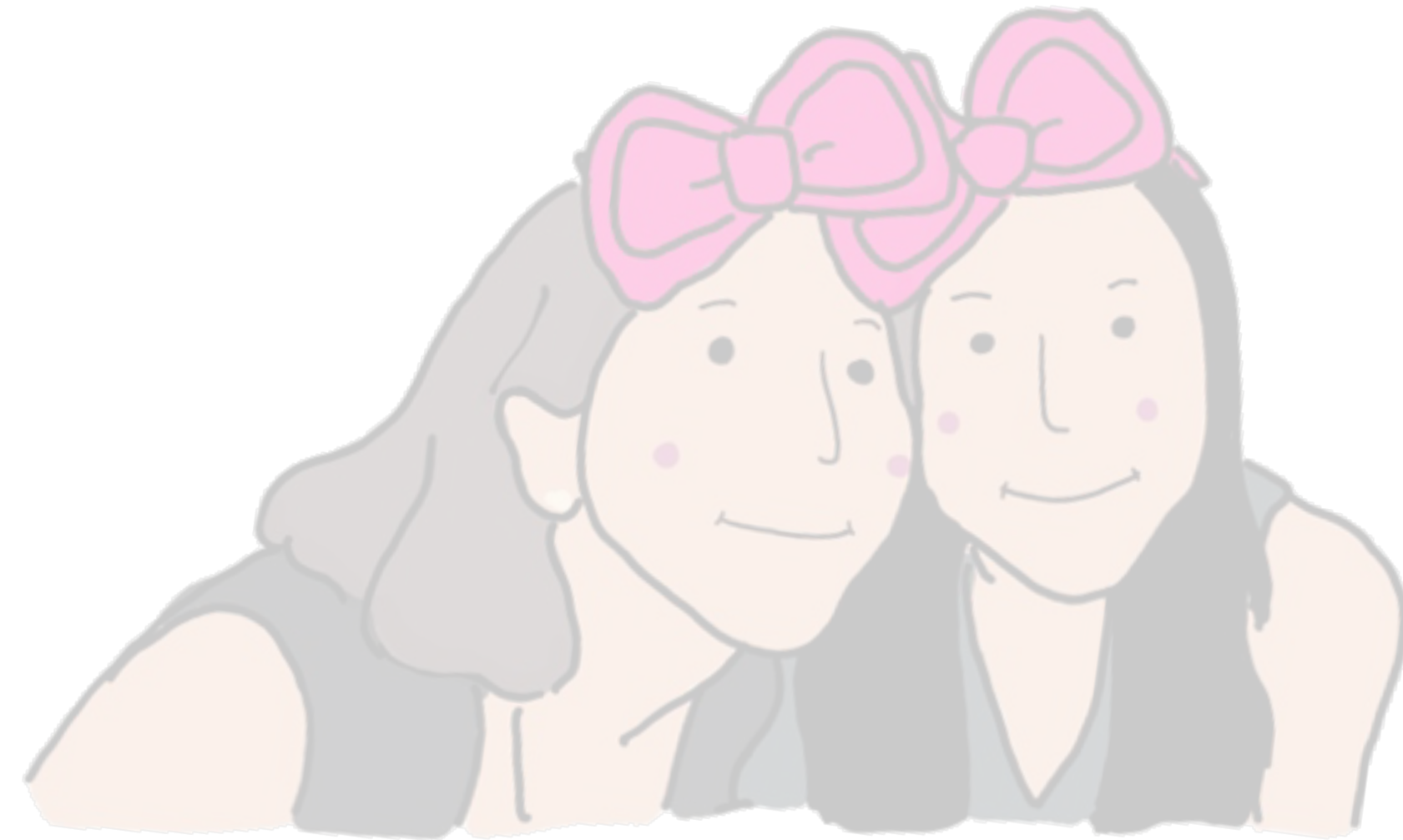
2.) What would a central bank increase as a part of an expansionary monetary policy to increase economic growth?

- A. Government spending
- B. Income tax
- C. Interest rate
- D. Money supply*



Exercise: Essay

1.) Explain how monetary policy can reduce the rate of inflation. [6]

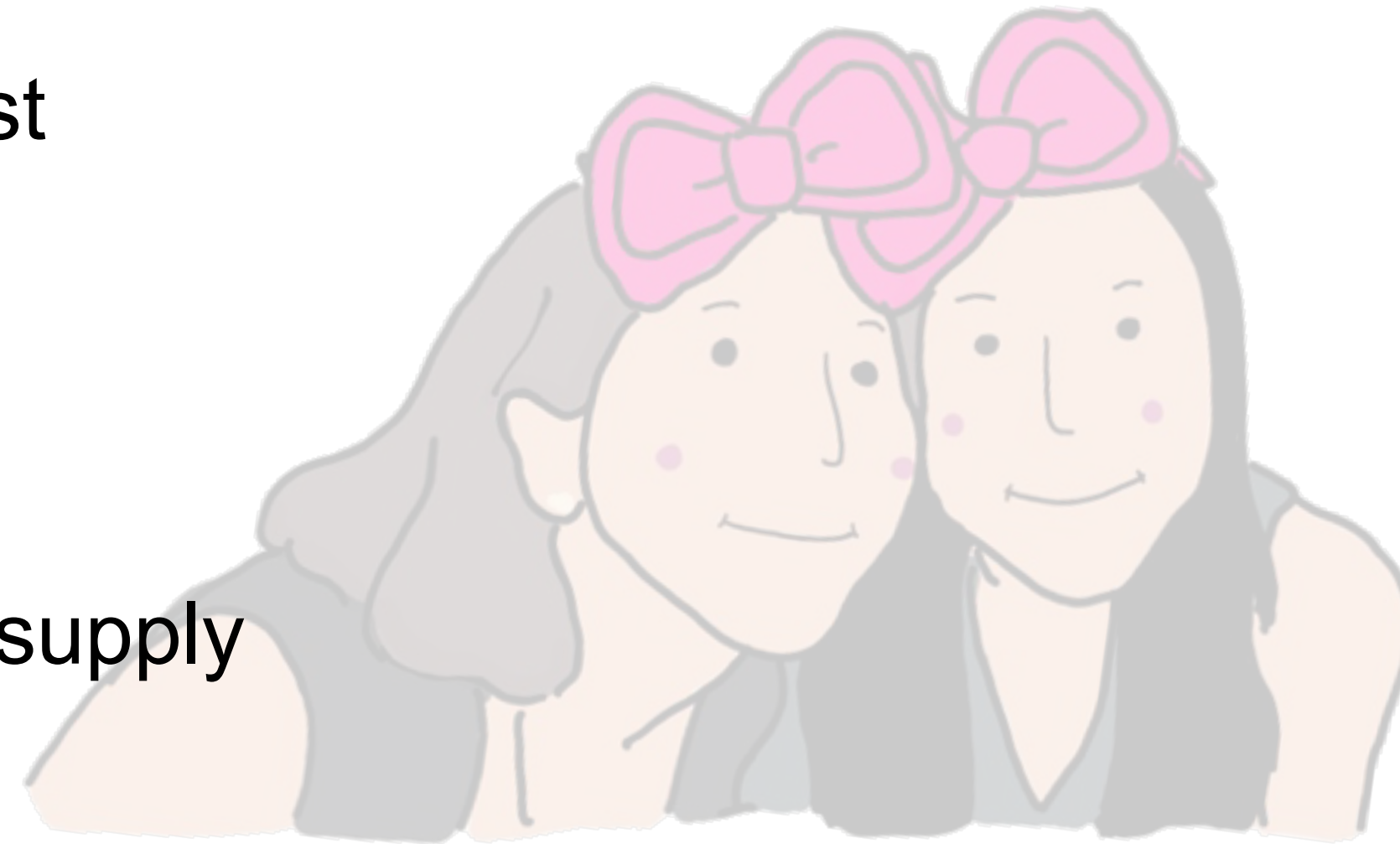


Exercise: Essay

1.) Analyse how monetary policy can reduce the rate of inflation. [6]

- A rise in the rate of interest

- A reduction in the money supply



- A rise in the exchange rate - reduce costs of imported raw materials

Knockout Economics



FB PAGE : KNOCKOUT.ECONOMICS



IG : KNOCKOUT.ECONOMICS



YOUTUBE : KNOCKOUT.ECONOMICS