Exercise walk-through

Fiscal and Monetary Policy Actions in the Short Run ▪ 5.1

eXercise

You must be able to

- combine **fiscal 财政** and **monetary 货币** policy to analyse their joint effect
- use the AD–AS and money-market models together
- state the goals of **stabilization policy 稳定政策**: full employment and price stability

Method — Two policy levers

Fiscal policy (spending and taxes) and **monetary policy** (money supply and interest rates) both shift **aggregate demand**.

Method — Used together

Trace an expansionary mix: more government spending shifts AD right directly, while a cut in interest rates raises investment, shifting AD right again.

Method — The goals

Stabilization policy aims for **full employment** and **price stability**.

Practice 2.1 ▪ 2 marks

State the two goals of stabilization policy.

Solution 2.1

Method: The goals

Worked steps

full employment and price stability **B1** **B1**.

Practice 2.2 ▪ 2 marks

State one fiscal and one monetary tool used to fight a recession.

Solution 2.2

Method: Two policy levers

Worked steps

fiscal: increase government spending (or cut taxes); monetary: cut interest rates (buy bonds) **B1** **B1**.

Practice 2.3 ▪ 1 mark

State which policy is run by the central bank.

Solution 2.3

Worked steps

monetary policy B1.

Exam-style 3.1 ▪ 1 mark

Stabilization policy aims for full employment and

- **A** high inflation
- **B** price stability
- **C** a trade surplus
- **D** low saving

Solution 3.1

Method: The goals

A high inflation

B price stability ✓

C a trade surplus

D low saving

Worked steps

B.

Exam-style 3.2 ▪ 1 mark

Both expansionary fiscal and expansionary monetary policy shift AD

A to the left

B to the right

C not at all

D downward

Solution 3.2

Method: Two policy levers

A to the left

B to the right ✓

C not at all

D downward

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

An economy is in a deep recession.

(a) Name an expansionary **fiscal** action.

(b) Name an expansionary **monetary** action.

(c) State the combined effect on AD.

Solution 3.3

Method: Two policy levers

Worked steps

(a) increase government spending or cut taxes **B1**. (b) buy bonds / cut interest rates **B1**. (c) AD shifts right (increases) **B1**.