4.3 Monetary policy

Name: ____________ Class: ________ Date: __________ **Total: 15 marks**

KEY WORDS interest rate 利率 • central bank 中央银行 • money supply 货币供给 • monetary policy 货币政策 • invest 投资

Objective

Build the skills to answer exam questions on **monetary policy 货币政策** — the **central bank 中央银行** changing **interest rates 利率**, and how this affects spending, growth and inflation.

You must be able to:

- define monetary policy and the interest rate
- explain how higher and lower interest rates affect the economy
- analyse the use of monetary policy

1 Worked examples

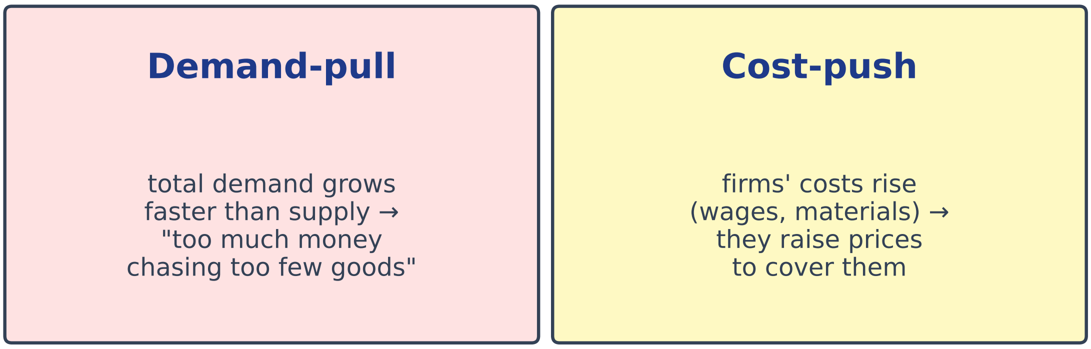
■ Interest rates

The interest rate is the cost of borrowing and the reward for saving

- **Monetary policy 货币政策**: the **central bank 中央银行** changes the **interest rate 利率**.
- **Lower rates:** borrowing cheaper → more spending and **investment 投资** →

more growth and jobs (but maybe inflation).

- **Higher rates:** borrowing dearer → less spending → less inflation (but maybe more unemployment).



Exam: demand-pull = AD excess; cost-push = rising costs (wages, oil, imported inputs)

Monetary policy's main target is inflation — a rate rise cools demand-pull pressure

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

2 Practice

2.1 Define the term *monetary policy*. [2]

2.2 State the effect of a **fall** in interest rates on consumer spending. [1]

2.3 State who sets the interest rate in an economy. [1]

3 Exam-style questions

3.1 To reduce inflation, a central bank should: [1]

- **A** lower interest rates
- **B** raise interest rates
- **C** raise government spending
- **D** cut income tax

3.2 Explain how a rise in interest rates could reduce inflation. [4]

3.3 Analyse the effects on an economy of a large cut in interest rates. [6]

Solutions

IGCSE Economics answers are marked by **level of response**: award **K** knowledge, **App** application, **An** analysis and **Ev** a justified judgement.

2.1 the central bank changing interest rates (and the money supply) to manage the economy (2 for a clear definition; 1 for a partial idea).

2.2 consumer spending rises (1).

2.3 the central bank (1).

3.1 **B**. Higher interest rates reduce spending and so reduce inflation.

3.2 *[4]* K 1 + An up to 3 — a higher interest rate makes borrowing dearer and saving more rewarding → people and firms spend and invest less → total demand falls → with lower demand, firms raise prices less → inflation falls.

3.3 *[6]* K/App/An — a large cut in interest rates makes borrowing cheaper and saving less rewarding → households and firms borrow and spend more, and firms invest more → total demand rises → output and jobs rise (more growth and lower unemployment) → but if demand grows faster than supply, prices may rise → so it can cause higher inflation.