A-LEVEL ECONOMICS • EXERCISE SHEET

# 5.3 Monetary policy

Name: ______________ Class: __________ Date: ____________ **Total: 26 marks**

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

## Objective

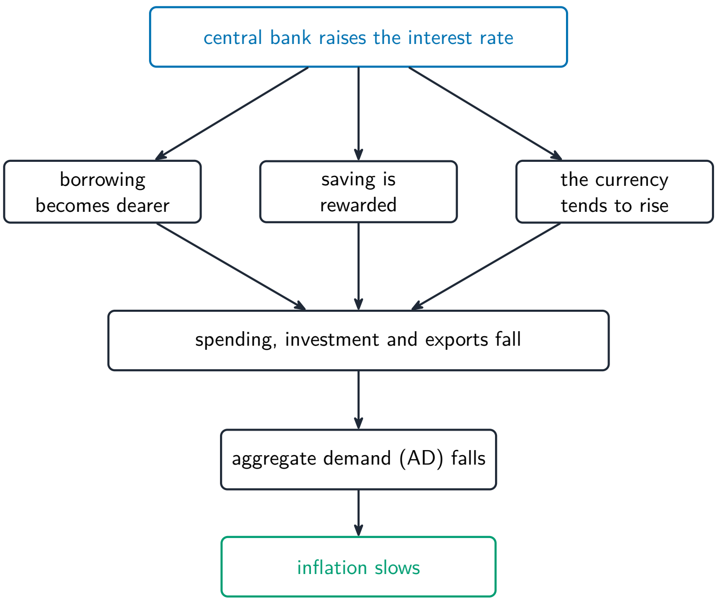
Build the skills to answer exam questions on **monetary policy 货币政策** — the **central bank 中央银行**, the **interest rate 利率**, the **transmission mechanism 传导机制**, and the effectiveness of monetary policy.

**You must be able to:**

- define monetary policy and name its main tool
- explain the transmission mechanism of an interest-rate change
- analyse the effectiveness of monetary policy

## 1 Worked examples

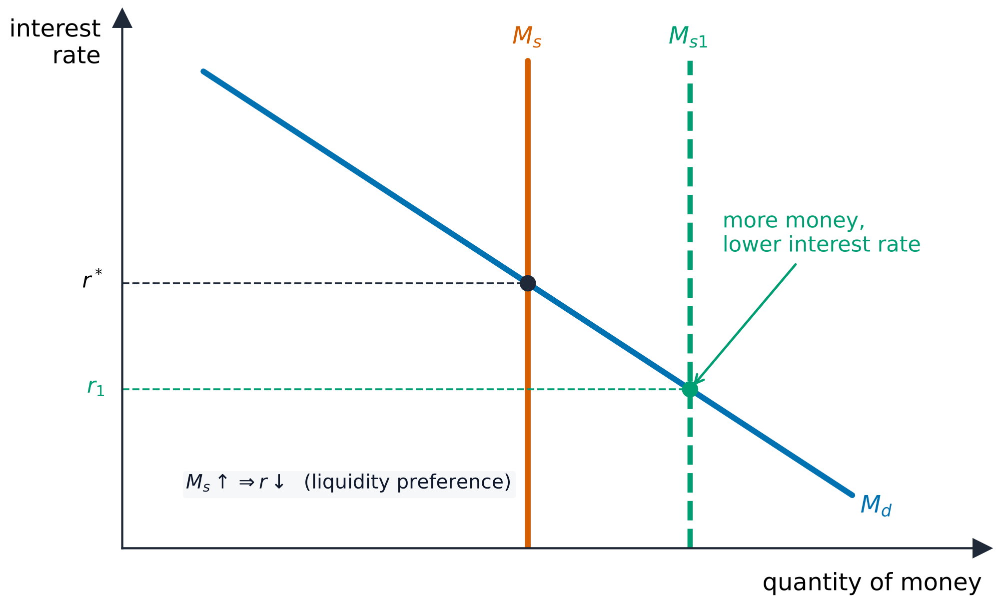
### The transmission mechanism




*A rate rise cuts spending, investment and exports — slowing inflation*

- **Monetary policy 货币政策** is run by the **central bank 中央银行**; its main tool is the **interest rate 利率**.

- A **higher** rate: borrowing dearer → less spending/investment; saving rewarded → less spending; currency rises → fewer exports → **AD falls**, slowing inflation.
- A **cut** does the opposite, raising AD.




*The money market: the central bank changes the interest rate that drives the transmission mechanism*

**Answer shapes:** an **Explain [up to 8]** answer should trace the transmission mechanism (AO3); **Discuss [12]** adds a judgement (AO4).

## 2 Practice

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

**2.2** State the main tool of monetary policy. [1]

**2.3** State two ways a higher interest rate reduces aggregate demand. [2]

## 3 Exam-style questions

**3.1** To reduce demand-pull inflation, a central bank should: [1]

| A | B |
|---|---|
| C | D |

**A** lower the interest rate
**B** raise the interest rate
**C** raise government spending
**D** cut income tax

**3.2** Explain how a rise in the interest rate works through the economy to reduce inflation. [8]

**3.3** Discuss whether monetary policy is always effective in controlling inflation. [12]