

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

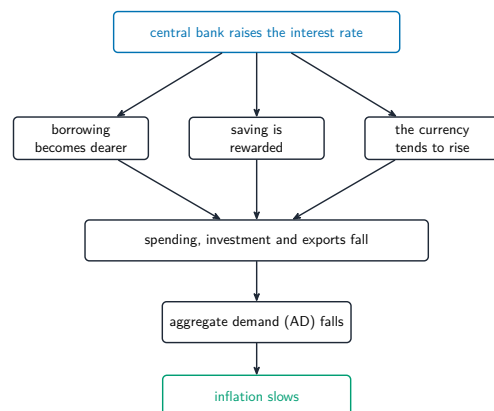
Build the skills to answer exam questions on **monetary policy** 货币政策 — the **central bank** 中央银行, the **interest rate** 利率, the **transmission mechanism** 传导机制, and the effectiveness of monetary policy.

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

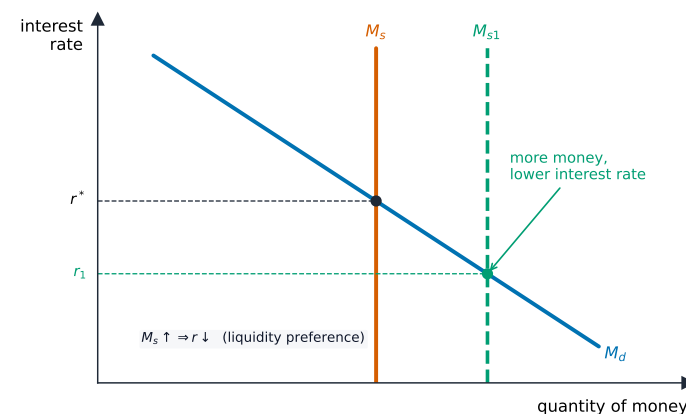
■ The transmission mechanism



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]