AP MACROECONOMICS • EXERCISE SHEET

4.6 Monetary Policy

Name: ____________ Class: ________ Date: __________ **Total: 9 marks**

KEY WORDS monetary policy 货币政策 • discount rate 贴现率 • open-market operations 公开市场操作 • contractionary (tight) 紧缩性 • expansionary (easy) 扩张性

Objective

Build the skills to answer exam questions on **monetary policy**.

You must be able to:

- define **monetary policy 货币政策** as the central bank's control of the money supply and interest rates
- distinguish **expansionary** (easy) from **contractionary** (tight) monetary policy
- describe the tools: **open-market operations 公开市场操作**, the reserve requirement, and the discount rate
- trace how a change in interest rates affects investment, AD, and output

1 Worked examples

Study these first. Each one shows the method for a question type used later.

■ Monetary policy

The central bank's control of the **money supply** and **interest rates** to steer the economy.

■ Expansionary vs contractionary

- **Expansionary** — buy bonds, cut the reserve ratio or discount rate → rates **down** → AD **up** (fights recession).
- **Contractionary** — the reverse (fights inflation).

■ The tools and transmission

Open-market operations, the **reserve requirement**, and the **discount rate**. Lower rates → more investment → higher AD → higher output.

2 Practice

2.1 Define monetary policy. [1]

2.2 Name the three tools of monetary policy. [2]

2.3 State the monetary policy used to fight a recession. [1]

3 Exam-style questions

3.1 To conduct expansionary monetary policy, a central bank [1]

- **A** sells bonds
- **B** buys bonds
- **C** raises the reserve ratio
- **D** raises taxes

3.2 When the central bank buys bonds, interest rates [1]

- **A** rise
- **B** fall
- **C** stay the same
- **D** become negative

3.3 A central bank wants to reduce high inflation.

(a) Name the type of monetary policy it should use. [1]

(b) State one tool and how it would be used. [2]

Solutions

2.1 the central bank's control of the money supply and interest rates to influence the economy.

2.2 open-market operations, the reserve requirement, the discount rate.

2.3 expansionary (easy) monetary policy.

3.1 B.

3.2 B.

3.3 (a) contractionary (tight) monetary policy. (b) e.g. sell bonds on the open market (or raise the reserve ratio / discount rate) to reduce the money supply.