

4.3 Monetary policy

Name: _____ Class: _____ Date: _____

Total: 15 marks

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

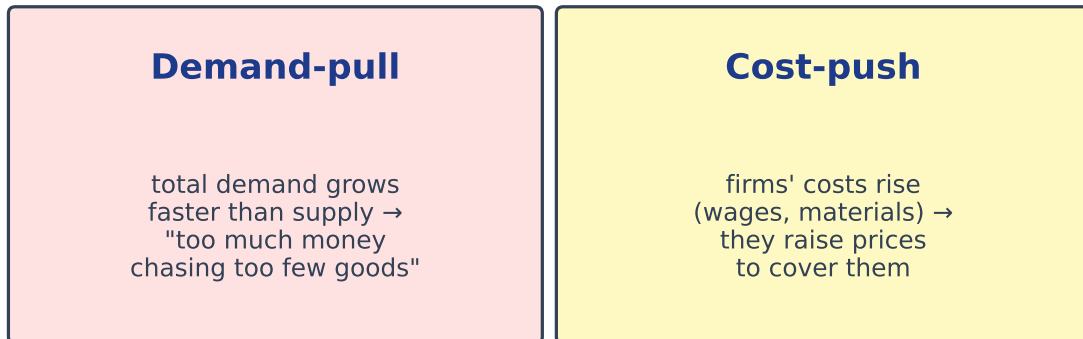


The interest rate is the cost of borrowing and the reward for saving

Image: source

- **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).



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]

4 Go further

You are now ready for the real exam questions on this subtopic. Open the **4.3 Monetary policy** past-paper sheet in the Library, or try these in **Practice mode**:

- 0455/12 N25 —Q19 (monetary policy)
- 0455/21 N25 —Q3 (interest rates, structured)
- 0455/22 N25 —Q4 (monetary policy, structured)

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.