# Chapter 27
# Monetary Policy

**Key terms**

1. Monetary policy : decision on the money supply, the rate of interest and the exchange rate taken to influence aggregate demand.
2. Foreign exchange rate : the price of one currency in terms of another currency.
3. Expansionary monetary policy : an increase in the money supply and lower interest rate to increase aggregate demand.
4. Contraction any monetary policy : a cut in the money supply and rise in interest rate to reduce aggregate demand

## 1. **Monetary policy**

: decision on the money supply, the rate of interest and the exchange rate taken to influence aggregate demand.

**Monetary Policy**

**Expansionary Monetary Policy**

- **Reducing interest rate**

: Lower cost of borrowing
: Increases in investment
: AD increases = C+I+G+NX
Or
: Lower benefits of saving
: People will save less and spend more
: AD increases = C+I+G+NX

- **Increase in Money supply**

: Central bank will purchase financial asset from commercial bank
: There will be more money supply that can lend to individual
: Consumption/Investment increase
: AD increases =C+I+G+NX

**Contractionary Monetary Policy**

- **Increasing interest rate**

: Higher cost of borrowing
: Decreases in investment
: AD decreases = C+I+G+NX
Or
: Higher benefits of saving
: People will save more and spend less
: AD decreases = C+I+G+NX

- **Decrease in Money supply**

: Central bank will sell financial asset from commercial bank
: There will be less money supply that can lend to individual
: Consumption/Investment decrease
: AD decreases =C+I+G+NX