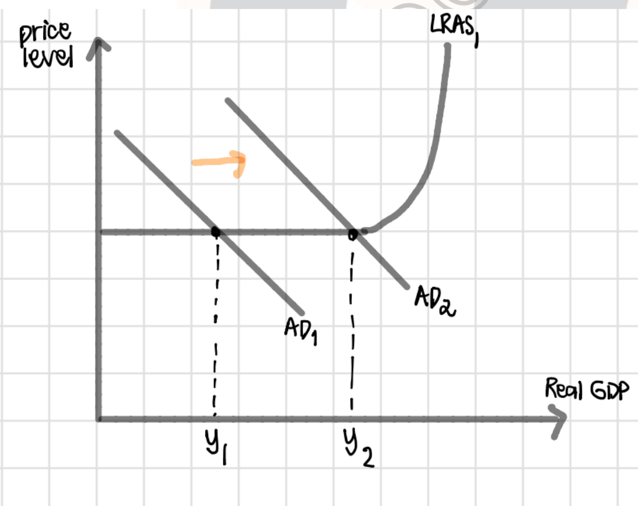
CHAPTER 40 : Macroeconomic Demand-side policies

Key terms

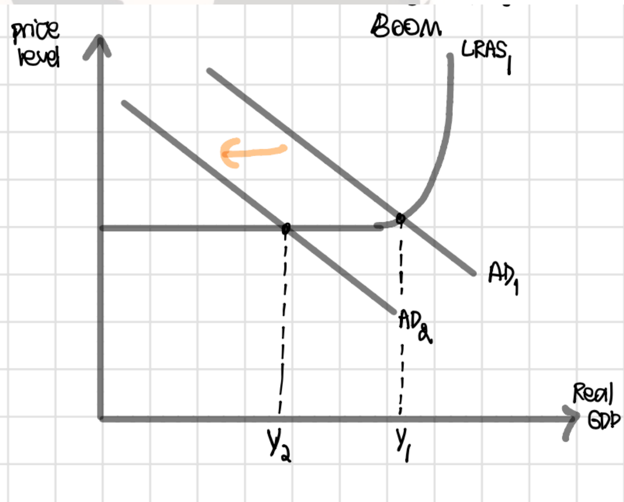
1. Balance budget : government statement of spending and income plans where spending is equal to its receipts, mainly tax revenue
2. Contractionary fiscal policy : fiscal policy that leads to a fall in AD
3. Contractionary monetary policy : monetary policy that leads to a fall in AD
4. Expansionary fiscal policy: fiscal policy that leads to a rise in AD
5. Expansionary monetary policy : monetary policy that leads to a rise in AD
6. Fiscal policy : the use of taxes, government spending and government borrowing by government to achieve its objectives
7. Monetary policy : government changes to monetary variables eg, Interest rates and the money supply , to achieve its objectives
8. Quantitative easing : a monetary policy instrument where the central buys financial assets in exchange for money in order to increase borrowing and lending in the economy

1. **<u>Fiscal Policy</u>** : the use of taxes, government spending and government borrowing by government to achieve its objectives

Economic recession	Economic boom
<u>Expansionary Fiscal Policy</u> **1. Reducing in tax** : People have more disposable income : People have more money to spend on goods and services : Higher consumption and higher AD **2. Higher Government Spending** : Government increases more projects : More job will be created : People have more income and spend more on goods and services : Higher consumption and higher AD	**<u>Contractionary Fiscal Policy</u>** **1. Increasing in tax** : People have less disposable income : People have less money to spend on goods and services : Lower consumption and lower AD **2. Lower Government Spending** : Government decreases more projects : Less job will be created : People have less income and spend less on goods and services : Lower consumption and lower AD



Expansionary Fiscal Policy



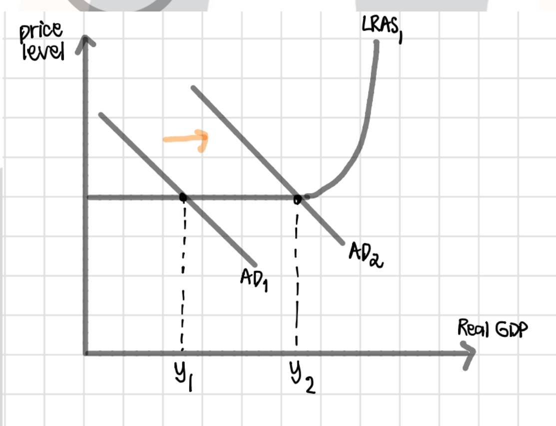
Contractionary Fiscal Policy

Limitation

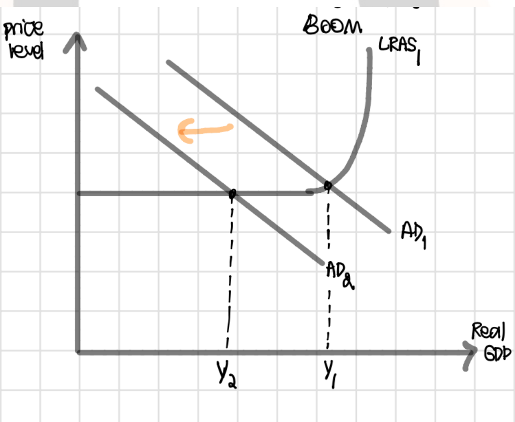
- It depends on other components of AD
- Higher tax can disincentive people to work
- Time lag
- Higher government spending can causes budget deficit

2. **<u>Monetary Policy</u>** : government changes to monetary variables eg, Interest rates and the money supply , to achieve its objectives

Economic recession	**Economic boom**
<u>Expansionary Monetary Policy</u> **1. Lower interest rate** : Savers receive lower return on saving while borrowers pay less cost of borrowing : Savers save less, Borrowers borrow more : Consumption and Investment increase : AD increases **2. Depreciated currency** : Export price becomes more competitive : Export increases, hence NX and AD increase. **3. Increase money supply** : Central bank buy financial asset from commercial : Commercial bank has more money to lend to individual : Individual has more money to spend on goods and services : AD increases	**<u>Contractionary Monetary Policy</u>** **1. Higher interest rate** : Savers receive higher return on saving while borrowers pay higher cost of borrowing : Savers save more, Borrowers borrow less : Consumption and Investment decrease : AD decreases **2. Appreciated currency** : Export price becomes less competitive : Export decreases, hence NX and AD decrease. **3. Decrease money supply** : Central bank sell financial asset from commercial : Commercial bank has less money to lend to individual : Individual has less money to spend on goods and services : AD decreases



Expansionary Fiscal Policy



Contractionary Fiscal Policy

Limitations

- Lag time
- Difficult to control Money supply
- It depends on other components in the economy
- The effect of interest rate depends on situation in the economy
- It can causes conflict with macro objectives