Summary

3.5 Demand management (demand-side policies)—monetary policy

Subject	Year	Start date	Duration
Economics	IB2	Week 4, October	1 week 2 hours

Course Part

Macroeconomics

Description

3.5 Demand management (demand-side policies): monetary policy, you should be able to:

- Be familiar with the following economics terminology: economic growth, inflation, recession, bailouts, fiscal stimulus, central bank, bond, reserve requirements, inflation targeting, business cycle, commercial bank, open market operations, minimum lending rate, quantitative easing, nominal interest rate, real interest rate, inflationary gap, deflationary gap, low consumer and business confidence
- Define monetary policy, money supply and the interest rate. Understand the relationship between the money supply and the interest rate
- Explain, with support of real-world examples, the goals of monetary policy, which are:
  - Inflation targeting
  - Low unemployment
  - Reducing business cycle fluctuations
  - Long-term economic growth
  - External balance
- Explain, with an example, the process by which banks can create money (HL only)
- Understand how the tools of monetary policy can affect the money supply and/or interest rate to grow the economy (HL only). These tools are:
  - Open market operations
  - Minimum reserve requirements
  - Minimum lending rate
  - Quantitative easing
- Use a diagram to show the determination of equilibrium interest rates (HL only)
- Understand the difference between nominal and real interest rates. You must be able to calculate both nominal and real interest rates
- Use AD/AS diagrams to explain how monetary policy can close recessionary and inflationary gaps
- Evaluate the effectiveness of monetary policy. Use real-world examples to help you explain:
  - The constraints of monetary policy
    - Limited scope for reducing interest rates when rates are close to 0
    - Low consumer and business confidence
  - The strengths of monetary policy
    - Incremental, flexible and easily reversible
    - Short time lags
  - Strengths and limitations promoting growth, low unemployment, and low and stable rate of inflation

Inquiry & Purpose

Inquiry / Higher Order Questions

Type	Inquiry Questions
Skills-based	The successes/failures of measures adopted to reduce income and/or wealth inequality, for a chosen country.

Curriculum

Objectives

Synthesis and evaluation (AO3)

Discuss and evaluate economic information and theories

Syllabus Content

Unit 3: Macroeconomics

Real-world issue 2 - How do governments manage their economy and how effective are their policies?

Conceptual understandings

Government intervention attempts to achieve macroeconomic objectives through a choice of policies.

Political, economic, social and environmental factors are interdependent and will influence the effectiveness of government policies.

Key concepts: scarcity, choice, efficiency, equity, economic well-being, sustainability, change, interdependence, intervention.

3.5 Demand management (demand-side policies)—monetary policy

Monetary policy

Control of money supply and interest rates by the central bank

Goals of monetary policy

Low and stable rate of inflation

Inflation targeting

Low unemployment

Reduce business cycle fluctuations

Promote a stable economic environment for long-term growth

External balance

The process of money creation by commercial banks (HL only)

Tools of monetary policy (HL only)

- Open market operations
- Minimum reserve requirements
- Changes in the central bank minimum lending rate (base rate/discount rate/refinancing rate changes)
- Quantitative easing

Demand and supply of money—determination of equilibrium interest rates (HL only)

Diagram (HL only): showing the determination of equilibrium interest rates

Real versus nominal interest rates

Calculation: real interest rates from given data

Expansionary and contractionary monetary policies to close deflationary/recessionary and inflationary gaps

Diagram: AD/AS curves showing expansionary and contractionary monetary policy

Effectiveness of monetary policy

- Constraints on monetary policy, including:
  - limited scope of reducing interest rates, when close to zero
  - low consumer and business confidence
- Strengths of monetary policy, including:
  - incremental, flexible and easily reversible
  - short time lags
- Strengths and limitations in promoting growth, low unemployment, and low and stable rate of inflation

Concepts

Government intervention attempts to achieve macroeconomic objectives through a choice of policies.

ATL Skills

Approaches to Learning

Thinking

- In this unit, we will
  - require students to take an unfamiliar viewpoint into account when formulating arguments
  - ask questions that required the use of knowledge from a different subject from the one you are teaching

Developing IB Learners

Learner Profile

Knowledgeable

Reflective