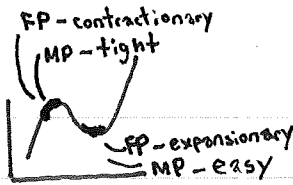


Monetary Policy



↳ contrast to Fiscal Policy

↳ both engage the same models

↳ defn - manipulating the money supply through interest rates

* THE SIZE OF THE MONEY SUPPLY IS CRITICAL TO THE ECONOMY

* MONEY SUPPLY should shadow growth in output/GDP *

(* the greater the money supply the less value the money has...)

to ensure balance betw money supply and output MONETARY POLICY
is used to adjust INTEREST RATES

↳ cost of borrowing money

linked directly to inflation/deflation.

① INFLATION = \uparrow is money supply
w/out an \uparrow in
economic output

② DEFLATION = \downarrow in money supply
w/out a \downarrow in output
↳ if money supply
too small and output
grows ... total
output may not
be purchased and
surplus/prices decrease

Bank of Canada

↳ objectives — ① price stability / protect the value of money — a consistently low inflation rate

— ② provide security to banking system / confidence

↳ arms length institution of gov't (Minister of Finance (Fiscal) & Governor (Monetary))

↳ POWER TO CREATE MONEY VS. POWER TO SPEND MONEY

TOOLS — \uparrow int. rates slows growth of money supply thus slowing inflation

— overnight lending rate (OLR) — \uparrow OLR \rightarrow dollar goes up \rightarrow int. rates \uparrow \rightarrow decrease demand \rightarrow prices/costs decrease — rate of inflation \downarrow

Flow CHART

\uparrow STAGE PROCESS $\left\{ \begin{array}{l} \text{tight} \\ \text{easy} \end{array} \right.$

tight money policy

① BC shifts deposits back from CB — CB reserve levels drop thus reducing the size of bank deposits available for lending

② Excess reserves in CB decreases thus decreasing the size of the money supply

③ CB ↑ interest rates thus discouraging the borrowing of money by

C
G
I

AS WELL

X?

④ less borrowing ↓ money supply growth

⑤ decrease in investment & spending — levers of GDP equation decrease

C
G
I

INJECTIONS

↑ in interest rates

size of money supply ↓

↑ value of dollar

↓ demand for exports due to high Canadian dollar

domestic rate of inflation

value of CDN dollar

EASY MONEY policy

↓ interest rates

↑ size of money supply

↓ value of CDN dollar

↑ demand of CDN exports due to lower CDN dollar