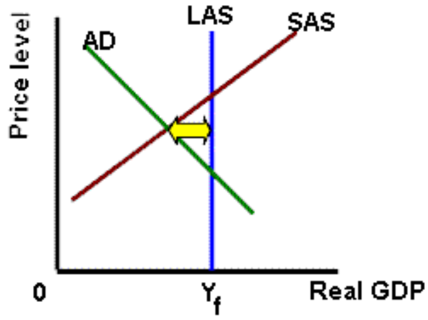
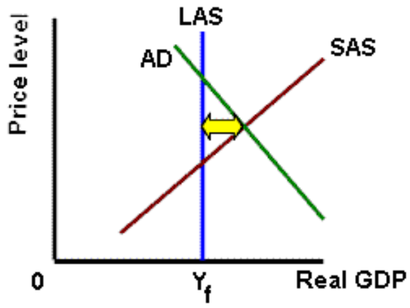
How to Push AD to Right (Recessionary Gap):

1. Automatic forces
   - Unemployment in the economy.
   - Wages going down.
   - Correct the gap.
2. Monetary policy- expansionary.
3. Fiscal policy- expansionary.



More than Full Employment Equilibrium:

- Expansionary phase.
- Objective is to bring AD to the left and close gap.



How to Push AD to Left (Expansionary Gap):

1. Automatic forces
   - Overworking, getting higher wages.
   - Cost of production increases, firms leave the market.
2. Monetary policy- contractionary.
3. Fiscal policy- contractionary.

TOPIC 8: MONETARY POLICY

Monetary Policy: Run by the central bank of any economy.

- **Instruments:** Cash rate and interest rate.
- **Objective:** Price stability.

Monetary Policy for Australia: The actions by the Reserve Bank to affect the price as well as the quantity of money and credit in order to influence economic activity.

- The actions taken by the RBA to affect interest rates to enable it to pursue macro economic objectives.
- Reserve Bank use of monetary policy operates by changing the change rate, which in turn changes the interest rates.
- The Reserve Bank uses the monetary policy through managing.
- **Demand for money:** Interest rate can be used.
- **Supply of money:** Open market operations can be used.
- The Reserve Bank uses to cash rate as its monetary policy instrument.

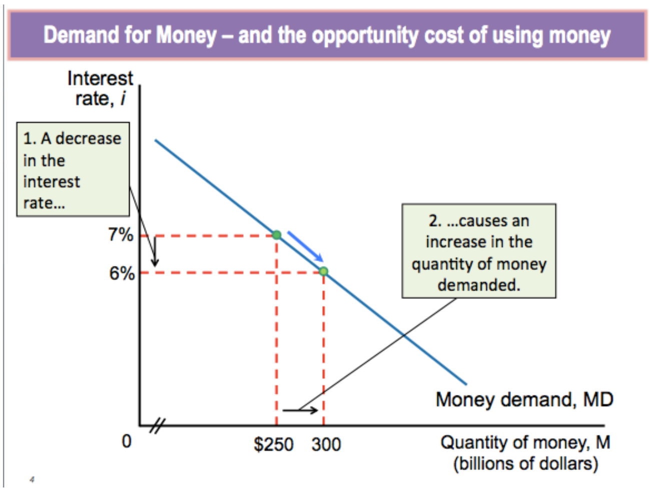
The Reserve Bank Act (1959):

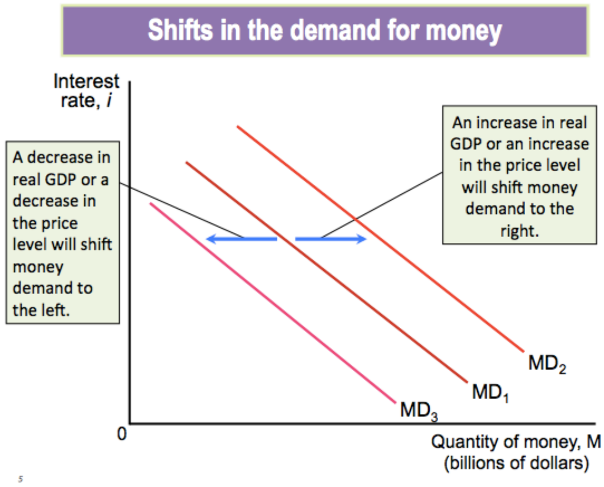
- Maintain the stability of the currency/ keep inflation low.
- Maintain full employment.
- Ensure the economic welfare and prosperity of the people of Australia.
- Focuses on price stability by keeping inflation low, economy grows faster with lower unemployment.
- Since 1993, the Reserve Bank has adopted an inflation target.
- To keep inflation between 2-3% average over the course of the business cycle.

Hubbard, Glenn, Anne Garnett, Phil Lewis, and Anthony O'Brien. 2015. *Introductory Economics* (Custom Edition). 1st edn, Sydney, NSW: Pearson Australia.

Monetary Policy Objective and Framework:

- **Rationale for an inflation target:**
  - The purpose of the Reserve Bank's policy action is more clearly understood by the financial market.
  - The target provides an anchor for expectations about future inflation.
- **Controversy about inflation targeting:**
  - Unemployment and real GDP growth rate may suffer.
  - Higher interest rates reduce household and firm spending which may result in slower growth in the short run.





Interest Rate Trends:

- A decrease in the interest rate causes an increase in the quantity of money demanded.
- A decrease in real GDP or a decrease in the price level will shift money demand to the left.
- An increase in real GDP or an increase in the price level will shift money demand to the right.
- The higher the interest rate- the better the economy is doing.
- Higher interest rate discourages people from spending.
- Negative interest rates- bank doesn't want the money, people more likely to spend it on hand.

Liquidity Trap: Once your interest rates hit 0, there is no improving/ going back.

Inflation Less than 2%:

- Prices are dropping.
- Sign of slow economy
- Want to expand the economy.
- Want to encourage people to spend/borrow money.
- RBA drop interest rates.
- C, I go up.
- AD goes up.
- Inflation is under control.

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