Your notes

GCSE Economics: revision notes

Monetary policy

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What monetary policy is

- **Monetary policy** is the use of **interest rates** (and the money supply) to influence the economy.
- In the UK, the Bank of England's **Monetary Policy Committee** (MPC) sets the **Bank Rate**. Its main aim is to keep inflation at the government's 2% target.

How interest rates work

- Raising **interest rates**: borrowing becomes more expensive and saving more attractive, so spending falls. **Mortgage** payments rise, leaving less to spend. Business investment falls. Demand and inflation fall, but growth may slow and unemployment rise.
- Cutting **interest rates**: borrowing is cheaper, saving less attractive, so spending and investment rise. Growth increases, but inflation may rise.
- **Interest rates** also affect the exchange rate: higher rates attract foreign savings, raising the value of the pound.

Quantitative easing

- **Quantitative easing** (QE) is when the central bank creates new money to buy government bonds, increasing the money supply. It was used after the 2008 financial crisis and during the pandemic, when **interest rates** were already very low.

Key terms

Monetary policy	Using interest rates and the money supply to influence the economy.
Bank Rate	The interest rate set by the Bank of England.
Monetary Policy Committee	The Bank of England committee that sets the Bank Rate.

Interest rate	The cost of borrowing and the reward for saving.
Quantitative easing	Creating new money to buy bonds and increase the money supply.
Mortgage	A loan to buy a house.

Quick questions

Cover the answers and test yourself: remembering is what makes it stick.

1. What is monetary policy?
2. Who sets the Bank Rate in the UK?
3. What is the main aim of UK monetary policy?
4. What happens to borrowing when interest rates rise?
5. How does raising interest rates reduce inflation?
6. What is a possible downside of raising interest rates?
7. What happens to saving when interest rates rise?
8. What is quantitative easing?

Answers

1. Using interest rates and the money supply to influence the economy
2. The Bank of England's Monetary Policy Committee
3. Keeping inflation at 2%
4. It becomes more expensive, so it falls
5. It reduces spending and demand
6. Slower growth and higher unemployment
7. It becomes more attractive
8. Creating new money to buy bonds

What to do next

Practise 10 questions on this topic

Try 3 exam questions, with mark schemes

Read the lesson, one step at a time

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