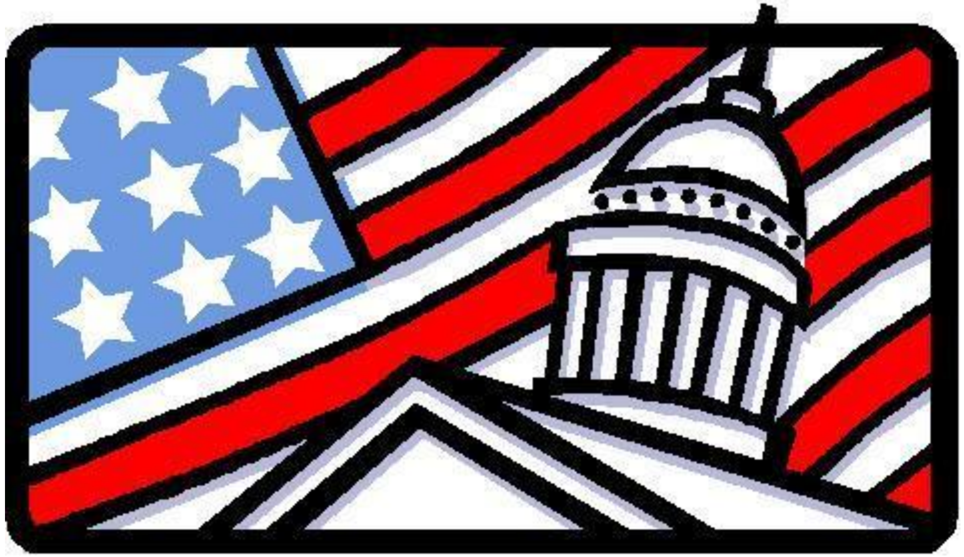
Monetary and Fiscal Policy

Tool which steers economy



The main objective of A government is to rise the quality of living of every citizen.

To Achieve this, Fair distribution of money is important.

Economic policy-makers have two kinds of tools to steer a country's economy: **fiscal** and **monetary**.

Fiscal Policy

Fiscal policy relates to government spending and revenue collection.

For example, when demand is low in the economy, the government can step in and increase its spending to stimulate demand. **Or**

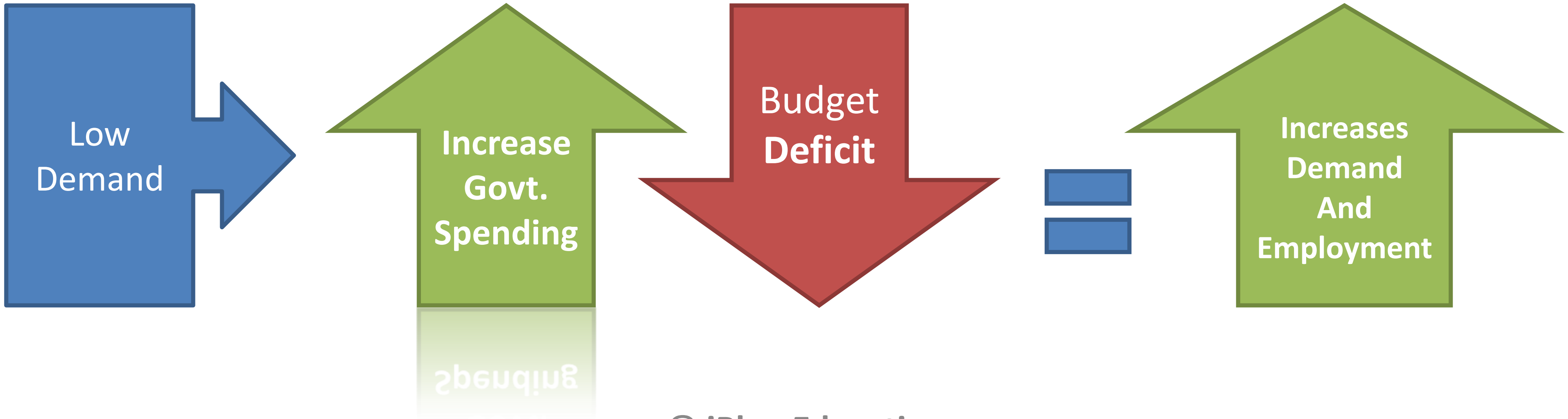
it can lower taxes to increase disposable income for people as well as corporations.

Fiscal Policy Tools: Taxes

Fiscal policy controlled by Ministry of finance in India and Treasury Security and Congress in USA.

Fiscal Policy Tools: Govt. Expenditure

The budget deficit goes up whether the government increases spending or lowers taxes



Fiscal Policy: Types

Policy measures taken to increase GDP and economic growth are called expansionary.

Measures taken to harness an "overheated" economy (usually when inflation is too high) are called contractionary.

Monetary Policy

Monetary policy directly relates to the supply of money, which is controlled via factors such as interest rates and reserve requirements (CRR) for banks.

For example,
to control high inflation, Central Bank can raise interest rates thereby reducing money supply.

Monetary Policy Tools: Interest Rates

Repo Rate: **At this rate Central Bank lends money to Commercial Bank.**

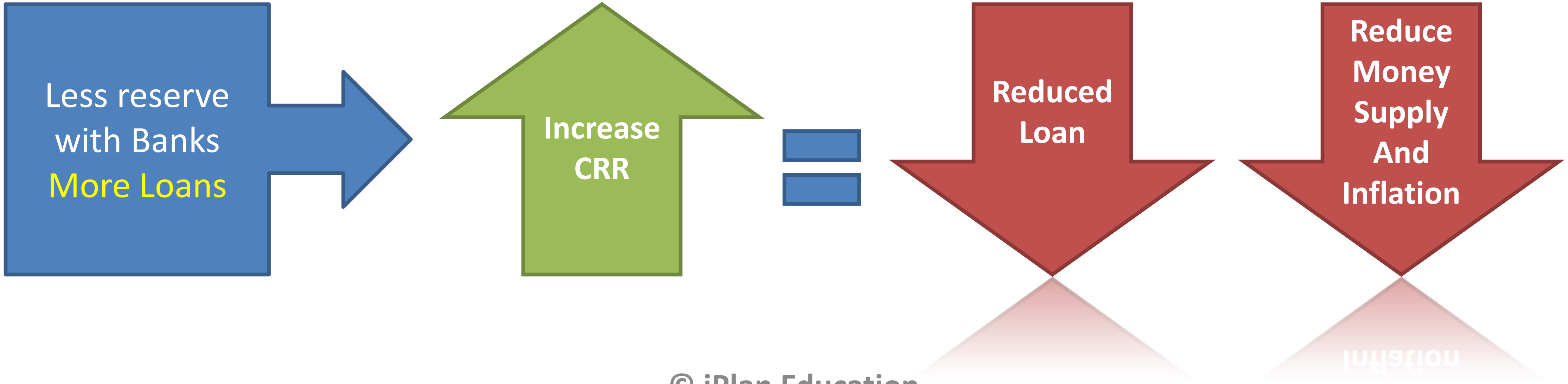
Reverse Repo Rate: **At this rate Banks lend money to Central Bank (RBI or FED).**

Monetary Policy Tools: Interest Rates

Monetary policy is controlled by RBI in India and Federal Reserve in USA.

Monetary Policy Tools: CRR

Banks are required to hold a certain percentage of their deposits in reserve. This is to meet cash withdrawal requests of their depositors. This reserve percentage is called cash reserve ratio.



Monetary Policy Tools: Open market operations

The Fed can create money out of thin air (Electronic) and inject it into the economy by buying government bonds (e.g. treasuries).