Subject: Economics	Topic: Introduction to macroeconomic policy	Year Group: 12

Macro-economic objectives

1	steady and sustainable rate of increase of national output (economic growth)
2	low level of unemployment
3	Low and stable rate of inflation
4	Favourable balance ofpayments position

Macroeconomic objectives

1	Economic growth is all about achieving a sustainable rate of growth in real GDP. If the economy grows too fast, inflation may accelerate because demand is growing and supply cannot keep up. Economic growth leads to higher living standards.
2	Low levels of unemployment are needed to maximise output and help achieve economic growth. It is also seen as a desirable social and political goal.
3	Low and relatively stable rates of inflation contribute to economic and political stability. Too high a rate is damaging to the economy because it is unpredictable and makes planning and investment more difficult, once again clashing with the objective of economic growth.
4	The current account is the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers. A positive balance of payments means that the money we earn from selling exports is greater than the money we pay for imports. If imports exceed exports a trade deficit develops; this will need to be financed by borrowing and may not be sustainable.

Exchange rate policy

The exchange rate affects the economy through its effect on the prices of exports and imports. The UK has a floating exchange rate and as such can be deliberately manipulated by monetary policy.
A stronger currency will cause imports to appear cheaper and exports dearer, this could worsen the current account. A weaker currency has the opposite effect
The UK has a floating exchange rate system (as opposed to a fixed).
With a floating exchange rate the price (exchange rate) of the currency is determined by the market forces of demand and supply. It behaves just like any good or service. The demand for, and supply of a currency are created by trade and investment flows. Higher interest rates tend to make the pound appreciate because investment in sterling assets becomes more attractive compared to other currencies, which increases the demand for pounds. Lower interest rates have the opposite effect.
The Bank of England does not specifically target the exchange rate but the Monetary Policy Committee (MPC) will take exchange rates into account.

What is Fiscal policy?

The use of government spending and taxes to influence the level of aggregate demand in the economy. (Often referred to as a demand side policy)
An increase in government spending or reduction in taxes will boost AD, can show this using an AD/AS graph and the resulting effect on real GDP
A decrease in government spending or increase in taxes will reduce AD, can show this using an AD/AS graph and the resulting effect on real GDP

What is Monetary policy?

The use of interest rates and the money supply to influence aggregate demand in the economy. (often referred to as a demand side policy)
An increase in interest rates and the reduction in the money supply will lead to a reduction in AD, can be shown using an AD/AS graph and the resulting effect on real GDP.
A drop in interest rates and expansion of the monetary supply will lead to an increase in AD, can show this using an AD/AS graph and the resulting effect on real GDP.

What are supply side policies?

These are policies designed to increase the productive potential of the economy. As such they seek to increase long run aggregate supply (LRAS)
They include anything that is designed to help the economy produce more and use existing resources more efficiently, such as education and training, incentives to encourage investment, developing a flexible labour force, reducing structural unemployment and encouraging R&D. Some taxes such as the working family tax credit act as an incentive to seek employment rather than stay on benefits. The government may also reduce benefits and reduce taxes on low incomes in an attempt to get people back into employment (the poverty trap).

Potential policy conflicts and trade-offs

All governments face potential policy conflicts and trade-offs. Solving one problem by using a particular policy can cause another problem to appear in its place.

Potential policy conflicts and trade offs		
Possible conflict		Explanation
1	Inflation rate vs unemployment	This is because attempts to control inflation use a contractionary fiscal or monetary policy which reduces AD and hence output, meaning less labour is needed and so unemployment rises. To reduce unemployment the government may use an expansionary fiscal or monetary policy which increases AD and reduces unemployment but may cause unsustainable growth and inflation.
2	Economic growth vs sustainable growth	Expanding economies require increasing amounts of energy, generating this power can lead to direct negative externalities in the form of pollution and also the long term external costs of the depletion of non-renewable resources.