CONCEPT: EXPANSIONARY AND CONTRACTIONARY MONETARY POLICY

● The Fed has two goals for monetary policy: managing employment (i.e. real GDP) and price stability (i.e. inflation)

□ When the economy is ***in recession***, real GDP is below its potential output

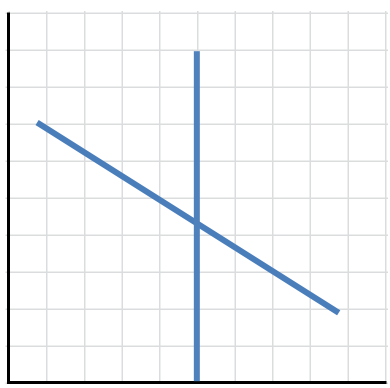
> Cyclical unemployment and low investment

> ***Expansionary monetary policy*** – Fed ______________ interest rates to stimulate economy

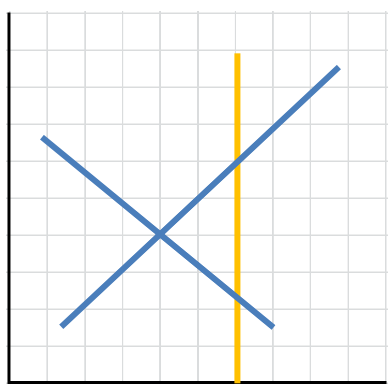
- Expansionary = more GDP

Expansionary Monetary Policy

Money Market



AD-AS Model



□ When the economy is experiencing ***rising inflation***, real GDP is above its potential output

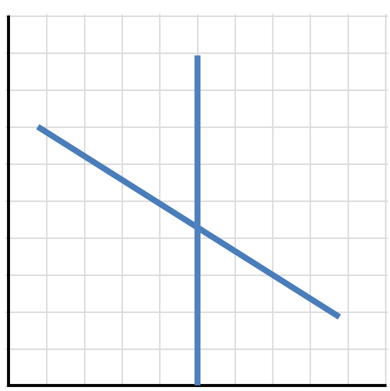
> Overemployment and increasing price levels

> ***Contractionary monetary policy*** – Fed ______________ interest rates to reduce inflation

- Contractionary = less GDP

Contractionary Monetary Policy

Money Market



AD-AS Model