

Cambridge IGCSE · Economics 0455 · Notes

Monetary policy

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Read first: [The macroeconomic aims of government](#)

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What you need to know

This topic has three syllabus outcomes. In plain words, you should be able to:

1. **Definitions:** say what the **money supply** is and what **monetary policy** is.
2. **Monetary policy measures:** describe the three tools: changing the **rate of interest**, changing the **money supply**, and changing the **foreign exchange rate**.
3. **Monetary policy and the aims:** explain how each tool can help the government reach its macroeconomic aims (economic growth, full employment, stable prices, balance of payments stability and a fairer distribution of income), and where using it for one aim can hurt another.

You do not need aggregate demand and aggregate supply diagrams: write about **total demand** (all the spending in the economy) in words. How banks work and what money is are in the money and banking topic; this topic is about using money and interest rates to steer the economy.

Understand it

Money supply and monetary policy

The **money supply** is the whole stock of money that people, firms and the government in an economy can use at a given moment. It is mostly **notes and coins in circulation** plus **money held in bank accounts**. It is not only the cash printed by the central bank, and it is not foreign currency.

Monetary policy is the use of the price and amount of money to influence spending in the economy as a whole. It is normally run by the **central bank** (sometimes on the government's instructions, often independently), and it works through three tools:

- the **rate of interest** (the price of borrowing money and the reward for saving it);
- the **money supply** (how much money is in the economy);
- the **foreign exchange rate** (the price of the country's currency in terms of other currencies).

Compare the other two policies in this part of the syllabus. **Fiscal policy** is the government changing **taxes and its own spending**. **Supply-side policy** aims to raise the economy's **capacity to produce** (training, privatisation, deregulation, labour-market reforms). Anything that changes a tax, a benefit, a subsidy, a tariff or a law is **not** monetary policy.

Two directions

- **Expansionary (loose) monetary policy:** **lower** the interest rate, **increase** the money supply, and/or let the currency **fall** in value (depreciation, or devaluation under a fixed rate). Total demand rises. Used against **unemployment**, slow growth, a **recession** or **deflation**.
- **Contractionary (tight) monetary policy:** **raise** the interest rate, **reduce** the money supply, and/or let the currency **rise** in value (appreciation, or revaluation). Total demand falls. Used against **inflation**.

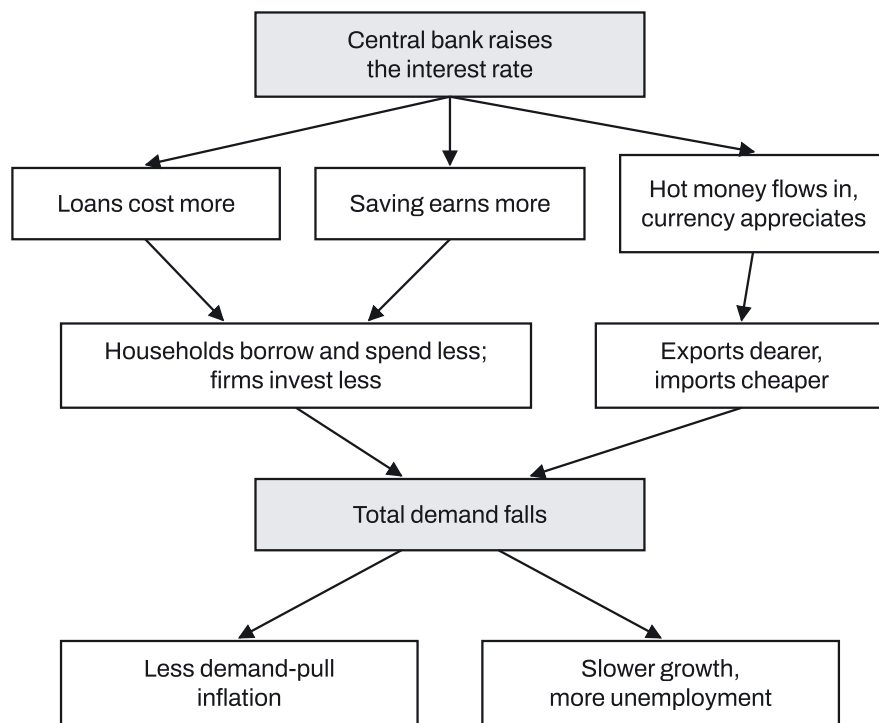
All three tools in one direction push the same way, so a mix such as "more money, cheaper loans and a weaker currency" is the strongest stimulus, and "less money, dearer loans and a stronger currency" is the strongest brake.

How a change in the interest rate spreads

Think of the interest rate as a price paid by borrowers and received by savers. When it rises:

1. **Borrowing costs more.** A household with a loan or a mortgage pays more each month, so it has less left to spend; fewer people take out new loans to buy cars, furniture or houses. **Consumer spending falls.**
2. **Saving pays more.** Each dollar left in the bank earns more, so people put off spending and save instead. **Consumer spending falls** again.
3. **Firms invest less.** A new factory or new equipment is usually paid for with borrowed money, so a higher rate makes the project dearer and less profitable; firms also expect weaker sales. **Investment falls.**
4. **The currency rises.** Savers abroad move money into the country's banks to earn the higher return (**hot money**). To do so they buy the currency, so its value goes up. The country's **exports become dearer** abroad and **imports become cheaper** at home, so net exports fall.

All four routes cut **total demand**. With less spending, firms cannot raise prices so easily, so **demand-pull inflation falls**. Cheaper imported raw materials and fuel also lower firms' costs, reducing **cost-push inflation**. But firms also produce less and need fewer workers, so output growth slows and **cyclical unemployment rises**. A big enough rise can tip the economy into a **recession**.



A **cut** in the interest rate works the other way: loans are cheaper, saving pays less, firms invest more, the currency tends to fall, and total demand **rises**. That raises output and jobs, but also raises the risk of **inflation**.

Some numbers. A firm with a \$200 000 loan pays \$8000 a year in interest at 4%, but \$14 000 at 7%: \$6000 a year less for wages, machines or profit. A saver with \$5000 in the bank earns \$100 a year at 2%, but \$250 at 5%. So a rate rise **hurts borrowers and helps savers**, and a rate cut does the opposite.

Changing the money supply

When there is **more money** in the economy, banks have more to lend, so loans become easier to get and cheaper (the interest rate tends to fall). Households and firms borrow and spend more, so total demand rises.

What that extra spending does depends on how much **spare capacity** the economy has:

- with **unemployed workers and idle machines**, firms can produce more, so output and jobs rise with little effect on prices;
- in an economy already working **at full capacity**, firms cannot make much more, so the extra spending mostly **pushes prices up** (demand-pull inflation).

Cutting the money supply makes loans harder to get, so spending and total demand fall and inflation eases.

Changing the foreign exchange rate

A central bank can push its currency down, for example by **selling** its own currency on the foreign exchange market or by **cutting** interest rates; it can push it up by **buying** its own currency or **raising** rates.

Take a phone made at home for 400 pesos. At \$1 = 20 pesos it costs a foreign buyer \$20. If the peso falls to \$1 = 25 pesos, the same phone costs only \$16 abroad, so more are sold.

- A **lower** exchange rate makes exports cheaper and imports dearer: exports rise, imports fall, so total demand, output and jobs rise and the **current account** improves. But dearer imported fuel, food and materials **raise inflation**.
- A **higher** exchange rate makes imports cheaper, which helps keep **inflation low**, but exports lose price competitiveness, so jobs in exporting firms are at risk and the current account may worsen.

A country with a **fixed** exchange rate (pegged to another currency) usually has to keep its interest rate close to the other country's rate, so it has less freedom to use monetary policy for its own aims.

Monetary policy and the macroeconomic aims

Aim	Monetary measure	How it helps
Stable prices (lower inflation)	Raise the interest rate; cut the money supply; a stronger currency	Less borrowing, more saving, less investment → total demand falls → less demand-pull inflation; cheaper imports → less cost-push inflation
Avoiding deflation	Cut the interest rate; raise the money supply; a weaker currency	More borrowing and spending → total demand rises → prices stop falling
Economic growth	Cut the interest rate; raise the money supply	Cheaper loans → more consumer spending and investment → firms produce more; more capital goods also raise future capacity
Full employment	Cut the interest rate; raise the money supply; a weaker currency	More spending and more exports → firms need more workers (labour is a derived demand) → cyclical unemployment falls
Balance of payments stability	A weaker currency; or a higher interest rate to reduce spending on imports	Exports cheaper, imports dearer → current account improves
Redistribution of income	Interest rate changes	A small, uneven effect: higher rates help savers and hurt borrowers; low inflation protects people on fixed incomes

Conflicts and limits

Monetary policy usually helps some aims at the cost of others:

- **Cutting** the interest rate helps **growth and employment** but can raise **inflation**, and the extra spending sucks in **imports**, worsening the current account.
- **Raising** the interest rate helps **stable prices** but slows **growth**, raises **unemployment**, makes the government's own **debt interest** dearer, and the stronger currency hurts **exporters**.

It may also not work as planned:

- **Confidence matters.** In a recession, worried households and firms may not borrow even when loans are cheap, so a rate cut does little.
- **Time lags.** Loans and investment plans change slowly, so the full effect can take a year or more.
- **The cause of inflation matters.** A rate rise cuts demand-pull inflation, but if prices are rising because oil or food costs more (cost-push), it mainly costs jobs.
- **Spare capacity matters.** Extra spending raises output only if firms can produce more; otherwise it raises prices.
- **Not every rate cut is passed on.** Commercial banks may keep their own lending rates high, or refuse loans to risky borrowers.
- **Debt.** Cheap, easy loans can leave households and firms owing more than they can repay if rates later rise.

Key facts and formulas

There is no formula list for 0455. "Learn it" means you must remember it.

Formula or fact	Status
Money supply: notes and coins in circulation plus money in bank accounts	Learn it
Monetary policy tools: interest rate, money supply, foreign exchange rate (usually run by the central bank)	Learn it
Expansionary: interest rate ↓, money supply ↑, currency ↓ → total demand ↑	Learn it
Contractionary: interest rate ↑, money supply ↓, currency ↑ → total demand ↓	Learn it
Yearly interest = amount borrowed or saved $\times \frac{\text{rate}}{100}$	Learn it
Foreign price of an export = $\frac{\text{home price}}{\text{home currency per unit of foreign currency}}$	Learn it
Rate rise: borrowers lose, savers gain; rate cut: borrowers gain, savers lose	Learn it

How to do it

We have tagged 38 questions on this topic (2021–2025): 26 multiple choice on Paper 1 and 12 structured questions on Paper 2. One multiple-choice question was set on two papers, so 37 are different. Each structured question has exactly one part about this topic (its other parts belong to other topics), so the counts below add up to 38.

Question type	Questions
Predict the effect of a change in interest rates or the money supply (MCQ)	13
Recognise monetary policy and the money supply (MCQ)	7
Choose the monetary measure for a given aim (MCQ)	6
Discuss whether a monetary policy change helps or harms the economy	6
Analyse how a monetary measure works through the economy	5
Explain how monetary policy differs from another policy	1

Written answers. Analyse (6 marks) and Explain (4 marks) are points-marked: a mark for each link in a chain of reasoning, so write **three developed chains** for 6 marks and **two** for 4. Discuss parts are worth 6 marks in Section A (up to 4 marks a side, a mark for each linked step) or 8 marks in Section B (levels-marked: Level 3, 6–8 marks, needs both sides developed and a judgement). Plan every Discuss answer the same way: **point** → **developed chain of reasoning** → **the other side (new points, not the first side turned round)** → **a justified judgement** that says what the answer depends on. Aim for two or three developed points a side.

1. Predict the effect of a change in interest rates or the money supply (MCQ) (13 questions)

1. Decide the **direction** of the change: dearer money (rate up, less money) or cheaper money (rate down, more money).
2. Run the chain: cost of borrowing → reward for saving → spending and investment → total demand → output, jobs and prices (plus the currency).
3. Pick the option that moves the **same way** as your chain. Watch for questions that ask which result would **not** happen.

Result	Interest rate rises	Interest rate falls
Borrowing and new loans	Fall	Rise
Saving	Rises	Falls
Consumer spending	Falls	Rises
Investment in capital goods	Falls	Rises
Exchange rate	Rises	Falls
Total demand, GDP	Fall	Rise
Unemployment	Rises	Falls
Inflation	Falls	Rises
Who gains	Savers, people living on interest	Borrowers, mortgage holders, firms that borrow

Result	Interest rate rises	Interest rate falls
Who loses	Borrowers, firms that borrow	Savers

Variations you will meet:

- **"Why does a rate rise work against inflation?"** The reason is on the saving and borrowing side: a better return persuades people to save more and spend less. Options that have firms or consumers borrowing **more** when loans are dearer, or the currency **falling**, run the wrong way.
- **"Which would not happen?"** Work out the direction of every variable from your chain first, then look for the one option that moves against it. With cheaper money everything on the demand side goes **up**, prices included, so any claim that inflation eases is the odd one out.
- **Linking to an aim in the short run.** Cheaper loans to boost growth mean firms produce more and hire more, so the aim helped at the same time is **lower unemployment**. The aim most at risk is stable prices.
- **Expansionary policy** pushes every demand variable the same way: borrowing, spending, sales, output and hiring all rise, and prices rise too if capacity is tight.
- **Money and spare capacity.** Whether extra money buys more output or just higher prices depends on how much room firms have to expand: with idle workers and machines output rises; when the economy is already working flat out, the extra spending shows up mainly as **demand-pull inflation**.

2. Recognise monetary policy and the money supply (MCQ) (7 questions)

All multiple choice.

- **Monetary:** anything about the **interest rate**, the **money supply** (including bank lending), or the **exchange rate** (including depreciating or devaluing the currency).
- **Not monetary:** income tax, sales tax, government spending, benefits (all **fiscal**); regulations, labour or trade-union laws, training, privatisation (**supply-side**); tariffs, quotas, import taxes (**protection**).
- **Money supply:** all the money in the economy that can be spent, cash and bank deposits together. Answers that cover only the central bank's notes, only commercial banks' deposits, or only foreign currency are too narrow.
- A rate rise used to hold down prices is **monetary policy**, whoever announces it.

3. Choose the monetary measure for a given aim (MCQ) (6 questions)

1. Name the aim and the direction it needs: **more** total demand (unemployment, recession, deflation, slow growth) or **less** (inflation).
2. Pick the matching tool:
 - more demand: **cut** the interest rate, **raise** the money supply, make lending easier, a **weaker** currency;
 - less demand: **raise** the interest rate, **cut** the money supply, a **stronger** currency.
3. If the question says "monetary", cross out every fiscal or supply-side option first, even if it would also work (an income tax rise also cuts inflation, but it is fiscal).

4. In a table where each option combines three tools, check **every** column points the same way: all three expansionary, or all three contractionary.

4. Discuss whether a monetary policy change helps or harms the economy (6 questions)

Section A 6 marks (up to 4 a side) or Section B 8 marks (levels). Questions: whether a rate **rise** harms the economy or should have happened; whether a rate **cut** reduces inflation or raises GDP; whether more **money supply** benefits the economy; whether a central bank should aim for **low inflation**.

A rate rise.

- *Harms*: the currency rises, so exporters lose orders abroad and the current account can worsen; households with mortgages pay more each month and others put money in the bank rather than the shops → retailers sell less → they cut staff; a business that has borrowed sees its interest bill grow and its profit shrink, so it shelves expansion or, if weak, closes; the state's debt becomes dearer to service, squeezing what is left for public services.
- *Helps*: savers and pensioners living on interest are better off; the cheaper foreign currency lowers the price of imported fuel and materials, so firms' costs and cost-push inflation fall, which in time helps them compete abroad; weaker spending eases demand-pull inflation, so wages and savings keep their value.
- *Judgement*: it depends on how high inflation is compared with its target, how much spare capacity there is, and how much people and firms have borrowed.

A rate cut.

- *Raises GDP / does not reduce inflation*: cheaper loans and lower rewards for saving → more consumer spending and investment → total demand rises → output and jobs rise, but so does demand-pull inflation; a weaker currency makes imports dearer.
- *Does not raise GDP / may reduce inflation*: if confidence is low, people may still not borrow; if there is no spare capacity, prices rise instead of output; extra demand may go on imports; but cheaper loans can also lower firms' costs and fund new machinery → more output in the long run → less cost-push inflation.
- *Judgement*: it depends on confidence, spare capacity and how quickly firms can expand.

More money supply.

- *Benefits*: banks lend more, often at lower rates → households spend more and firms find it easier to finance expansion → total demand, output and jobs rise; useful in a recession or when prices are falling.
- *Does not*: easy credit → households and firms build up debts they may struggle to repay later; if output cannot keep up, too much money chases too few goods → **inflation**, so each dollar buys less; part of the extra spending goes on foreign goods → the current account worsens.
- *Judgement*: it depends on how much spare capacity there is and how big the increase is.

Should a central bank aim for low inflation? Start with the costs of the target: to hold inflation down the bank may have to keep loans dear, which holds back spending, investment and hiring; if it overshoots, prices can start to fall, and households then delay purchases, which can deepen a slump; and gently rising prices and

profits can give businesses a reason to grow. Then the gains: if prices rise slowly, pay rises keep ahead of them, so **real wages** hold up; shops and firms spend less time and money changing price lists (**menu costs**); people on pensions or living on savings keep their buying power; and the country's goods stay cheap compared with foreign rivals, which supports exports and jobs. Judge by how far inflation is above the target and how fast the economy is growing.

5. Analyse how a monetary measure works through the economy (5 questions)

Analyse, 6 marks. Write three chains, each step one mark, each ending at the result in the question.

- **How a rate rise cuts total demand** (or causes a recession): dearer loans (1) → households take out fewer loans and spend less (1); saving earns more (1) → people spend less of their income (1); firms find investment dearer (1) → they buy less new equipment (1); hot money flows in (1) → the currency rises (1) → exports fall and imports rise (1) → total demand falls (1). For a **recession**, carry on: firms sell less → produce less → cut jobs → real GDP falls.
- **How a central bank could reduce inflation**: name the tool, then the chain. Raise the interest rate (chain above → less demand-pull inflation); cut the money supply (less lending → less spending); let the currency rise (cheaper imported materials → lower costs → less cost-push inflation).
- **How a central bank could avoid deflation**: the same three tools the **other way round**: cut the rate, raise the money supply, push the currency down → more borrowing, spending and exports → total demand rises → firms can raise prices. A central bank cannot change taxes or government spending, so keep to monetary tools.
- **How a rate cut can make aims conflict**: cheaper loans → more spending and investment → output and jobs rise (growth and employment helped) → but demand may outrun supply → demand-pull inflation (price stability harmed); more spending also goes on imports, and the weaker currency makes imports dearer → the current account may worsen.

6. Explain how monetary policy differs from another policy (1 question)

Explain, 4 marks: two differences, each identified (1) and explained by saying what **each** policy does (1).

Useful differences, against **fiscal** or **supply-side** policy:

- **the tools**: interest rate, money supply and exchange rate, compared with taxes and government spending (fiscal) or training, privatisation and deregulation (supply-side);
- **what it works on**: monetary and fiscal policy change total **demand**; supply-side policy raises the economy's capacity to **supply**;
- **speed**: a rate change can be made at once and acts within months; new skills or new competition take years to raise capacity;
- **who decides**: in most countries the central bank sets monetary policy; ministers set fiscal and supply-side policy;
- **direction**: monetary policy can be loosened or tightened, to speed the economy up or cool it; supply-side policy only ever aims to make it grow.

Worked examples

Example 1

(a) Define money supply. [2]

(b) Explain why a central bank might cut the rate of interest when an economy is in a recession. [4]

(a) The money supply is the total amount of money in an economy that can be used to buy things (1), made up of notes and coins in circulation together with money held in bank accounts (1).

(b) In a recession output is falling and unemployment is rising, so the central bank wants more spending (1). A lower rate makes loans cheaper and saving less worthwhile, so households spend more and firms borrow to invest (1). The extra spending lifts total demand, so firms raise output (1) and hire more workers, which reduces cyclical unemployment and helps the economy back towards growth (1).

Example 2

A central bank has cut its interest rate from 6% to 3%. A small firm has a \$40 000 loan, and a retired couple have \$80 000 in a savings account; both are charged or paid the central bank's rate.

(a) Calculate the change in the firm's yearly interest bill and in the couple's yearly interest income. [2]

(b) Analyse how a cut in the interest rate could reduce unemployment. [6]

(a) Firm: $\$40\,000 \times 6\% = \2400 before, $\$40\,000 \times 3\% = \1200 after, so its interest bill **falls by \$1200** a year (1). Couple: $\$80\,000 \times 6\% = \4800 before, $\$80\,000 \times 3\% = \2400 after, so their income **falls by \$2400** a year (1).

(b) A lower interest rate makes borrowing cheaper (1), so households take out more loans to buy cars, furniture and houses (1). Saving now earns less, so people spend more of their income instead (1). Firms find it cheaper to borrow for new equipment and buildings, so investment rises (1). Higher consumer spending and investment raise total demand (1), so firms produce more and need more workers, as the demand for labour is derived from the demand for goods (1), and cyclical unemployment falls (1). The currency may also fall as hot money leaves, making exports cheaper (1), so exporting firms take on more workers (1). (Any 6.)

Example 3

Discuss whether or not higher interest rates benefit households. [8]

Higher interest rates are part of contractionary monetary policy, set by the central bank. Households can be savers, borrowers, workers and shoppers at once, so the effects differ from one household to another.

Why they may benefit. Households with money in the bank earn more on it. A retired person living on \$60 000 of savings at a rate that rises from 2% to 5% would see yearly interest grow from \$1200 to \$3000, so they can spend more without touching their savings (developed point for).

Dearer loans cut total demand, so prices rise more slowly. Wages and pensions then keep more of their buying power, and a stronger currency makes imported food, fuel and holidays cheaper, which raises households' living standards (developed point for).

Why they may not. Families with a mortgage or a car loan on a variable rate must pay more each month, so they have less left for food, clothing and leisure; some may fall behind on repayments and lose their homes (developed point against).

As households and firms spend less, shops and factories sell less and cut staff. Workers who lose their jobs lose their incomes, and others may get smaller pay rises, so many households end up worse off even if prices are steadier (developed point against).

Judgement. It depends on whether a household is mainly a saver or a borrower, and on how far the rate rises. Older households with savings and no debts tend to gain; young families with large loans and jobs in industries that rely on borrowing tend to lose. If the rise brings high inflation under control quickly, most households gain in the long run. Both sides are developed and the judgement says what the answer depends on, so this meets the Level 3 descriptor (6–8 marks).

Common mistakes

- **Giving fiscal tools to the central bank.** Examiners report this almost every year: answers have the central bank cutting taxes or raising government spending. A central bank changes interest rates, the money supply and the exchange rate; taxes and spending belong to the government. A question about what a central bank could do only rewards monetary tools.
- **Mixing up deflation and inflation.** In a question about **avoiding deflation**, some answers explained a rate rise, which is the cure for inflation. Falling prices need **more** demand: lower rates and more money.
- **Getting the direction wrong.** A higher interest rate **reduces** borrowing and consumer spending and **raises** saving. Some answers claimed businesses would put more into new projects after a rate rise, on the grounds that bank deposits now pay better; in fact dearer loans make new projects less worthwhile, so investment falls.
- **Unexplained jumps.** "More money supply → the currency falls" with no reason earns little. Give each link: more money → lower interest rates → less hot money flowing in → less demand for the currency → it falls.
- **Answering a different question.** Some answers about a rate rise drifted into the pros and cons of a strong currency, or of saving in general. Use the exchange rate as one link, then come back to the policy in the question.
- **Turning a point round for the other side.** "A rate cut raises spending" for, then "a rate rise lowers spending" against, is the same point. The other side needs a **new** reason: confidence, spare capacity, imports, cost-push inflation, debt.
- **Long, tangled sentences.** Examiners noted sentences ten lines long. One link per short sentence makes each mark easy to see.

How to get the marks

- **Define** (2 marks): two parts, for example "the use of interest rates, the money supply and the exchange rate (1) to influence total demand and the macroeconomic aims (1)"; "all the money available to spend in an economy (1), notes and coins plus bank deposits (1)".
- **Identify** (2 marks): two precise answers, such as "raising the interest rate" and "reducing the money supply". Only the first ones you write count.
- **Explain** (4 marks): two points, each identified (1) and developed (1). For a difference, say what **both** policies do.
- **Analyse** (6 marks): a mark per link. Three chains, each starting with the measure and ending at the result in the question (total demand, inflation, unemployment, recession).
- **Discuss** (6 or 8 marks): both sides developed with **different** reasons, then a judgement that says **what it depends on** (the cause of inflation, spare capacity, confidence, the size of the change). In Section A use the source: if it gives the inflation rate, a target or the currency's movement, quote it.
- **Use economic terms**: cost of borrowing, reward for saving, consumer expenditure, investment, total demand, demand-pull and cost-push inflation, cyclical unemployment, appreciation and depreciation, hot money, expansionary and contractionary.
- **Multiple choice**: 1 mark each, no penalty for guessing. Write the direction (↑ or ↓) next to each variable before you choose.

Quick check

1. A central bank wants to slow down rising prices. Which action should it take?
 - **A** lower the rate of interest
 - **B** reduce the money supply
 - **C** cut the rate of sales tax
 - **D** allow the currency to depreciate
2. A firm has a \$300 000 loan. The interest rate on it rises from 3% to 5%. By how much does the firm's yearly interest bill rise?
 - **A** \$6000
 - **B** \$9000
 - **C** \$15 000
 - **D** \$24 000
3. Which group is most likely to be better off after interest rates are raised?
 - **A** retired people living on the interest from their bank deposits
 - **B** firms planning to borrow to build a new factory
 - **C** families repaying a mortgage at a variable rate
 - **D** firms that sell most of their output abroad
4. A shirt is made at home for 600 rupees. The exchange rate changes from \$1 = 30 rupees to \$1 = 40 rupees. Calculate the shirt's price in dollars before and after, and say whether this change helps or hurts exporters.

5. Explain two ways in which a rise in the rate of interest could reduce consumer spending. [4]

Answers

1. **B.** Less money means fewer, dearer loans, so spending and demand-pull inflation fall. A and D are expansionary and would raise demand; C is fiscal, not monetary, and would also raise demand. (1)
2. **A.** Before: $\$300\,000 \times 3\% = \$9\,000$. After: $\$300\,000 \times 5\% = \$15\,000$. The bill rises by $\$15\,000 - \$9\,000 = \$6\,000$. (1)
3. **A.** Savers earn more interest. Borrowers (B, C) pay more, and the stronger currency makes exports dearer (D). (1)
4. Before: $600 \div 30 = \$20$. After: $600 \div 40 = \$15$. The rupee has fallen in value, so the shirt is cheaper abroad: this **helps** exporters, who should sell more. (1) (1)
5. Borrowing becomes more expensive (1), so households take out fewer loans to buy items such as cars and furniture, and those with loans have less left to spend after repayments (1). Saving becomes more rewarding (1), so households save a larger share of their income and spend less of it (1).

Past questions to try

- **0455/13/M/J/24 Q19:** which statement about monetary measures and the aims is correct.
- **0455/21/O/N/21 Q4:** part (c), how a higher interest rate reduces total demand.
- **0455/22/O/N/24 Q1:** part (h), whether a central bank should have raised the interest rate, using a source.
- **0455/23/O/N/24 Q5:** part (d), whether a cut in the interest rate will reduce inflation.