

How Monetary and Fiscal Policy Work

Monetary Policy

- **Definition:** The process by which the central bank (Bank of Canada) controls money supply, interest rates, and credit availability to stabilize the economy.
- **Goal:** Maintain inflation control, economic stability, and employment growth.

Monetary Policy Tools

1. **Interest Rates:**
 - Higher interest rates make borrowing more expensive, slowing down economic activity.
 - Lower interest rates make borrowing cheaper, stimulating spending and investment.
2. **Money Supply Control:**
 - The Bank of Canada adjusts the money supply to influence inflation and economic growth.
3. **Reserve Requirements:**
 - Regulations on the minimum reserves banks must hold, affecting how much they can lend.

Impact of Monetary Policy

- **Expansionary Monetary Policy** (Lower Interest Rates, Increased Money Supply):
 - Encourages borrowing and investment
 - Boosts economic growth
 - May lead to inflation if overused
 - **Contractionary Monetary Policy** (Higher Interest Rates, Reduced Money Supply):
 - Reduces inflationary pressures
 - Slows down economic growth
 - Can increase unemployment if too strict
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Fiscal Policy

- **Definition:** Government policies on taxation and spending to influence economic conditions.
- **Goal:** Manage economic growth, control inflation, and reduce unemployment.

Fiscal Policy Tools

1. **Government Spending:**
 - Increased spending (on infrastructure, social programs) boosts economic activity.
 - Reduced spending slows economic growth.
2. **Taxation:**
 - Higher taxes reduce consumer spending and business investment.
 - Lower taxes increase disposable income, stimulating demand.
3. **Transfer Payments:**
 - Welfare, unemployment benefits, and subsidies affect income distribution and economic activity.

Impact of Fiscal Policy

- **Expansionary Fiscal Policy** (Increased Spending, Lower Taxes):
 - Stimulates demand and economic growth
 - Can lead to higher inflation and government debt
- **Contractionary Fiscal Policy** (Reduced Spending, Higher Taxes):
 - Slows down inflation
 - May cause reduced economic growth and higher unemployment

Comparison of Monetary & Fiscal Policy

Feature	Monetary Policy	Fiscal Policy
Controlled By	Bank of Canada	Government (Federal & Provincial)
Main Tools	Interest rates, money supply	Taxes, government spending
Speed of Impact	Faster (direct effect on markets)	Slower (depends on legislative process)
Flexibility	Adjusted frequently	Changes take longer to implement
Primary Goal	Price stability & economic stability	Economic growth & employment

Real-World Examples

- **Monetary Policy Example:** During a recession, the Bank of Canada lowers interest rates to encourage borrowing and investment.
- **Fiscal Policy Example:** The government increases infrastructure spending to create jobs and stimulate the economy.

Understanding how these policies work helps predict economic trends and the government's response to economic challenges.