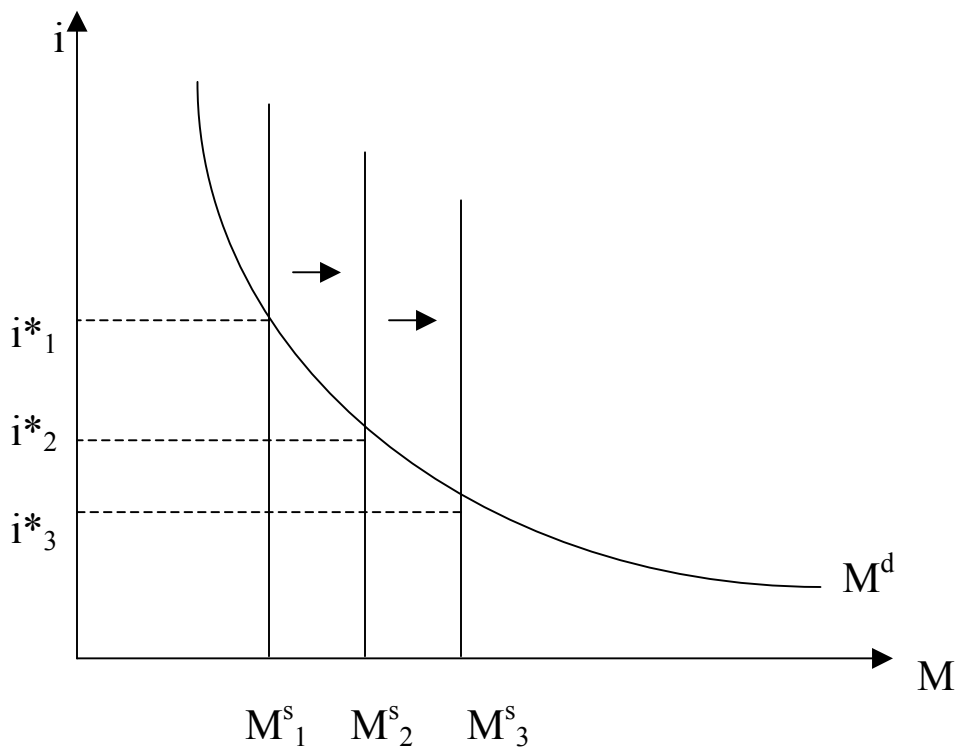


## Keynesian Monetary Policy

As we mentioned before, the three major macroeconomic issues that we want to deal with are: inflation, unemployment, and recession/depression. Here, we'll discuss two Keynesian monetary policies, one that deals with unemployment (and economic growth), and the other deals with inflation.

### Keynesian Expansionary Monetary Policy (KEMP):

KEMP:  $\uparrow M_s \rightarrow \downarrow i \rightarrow \uparrow I \rightarrow \uparrow Y$  (if  $Y < Y_f$ )

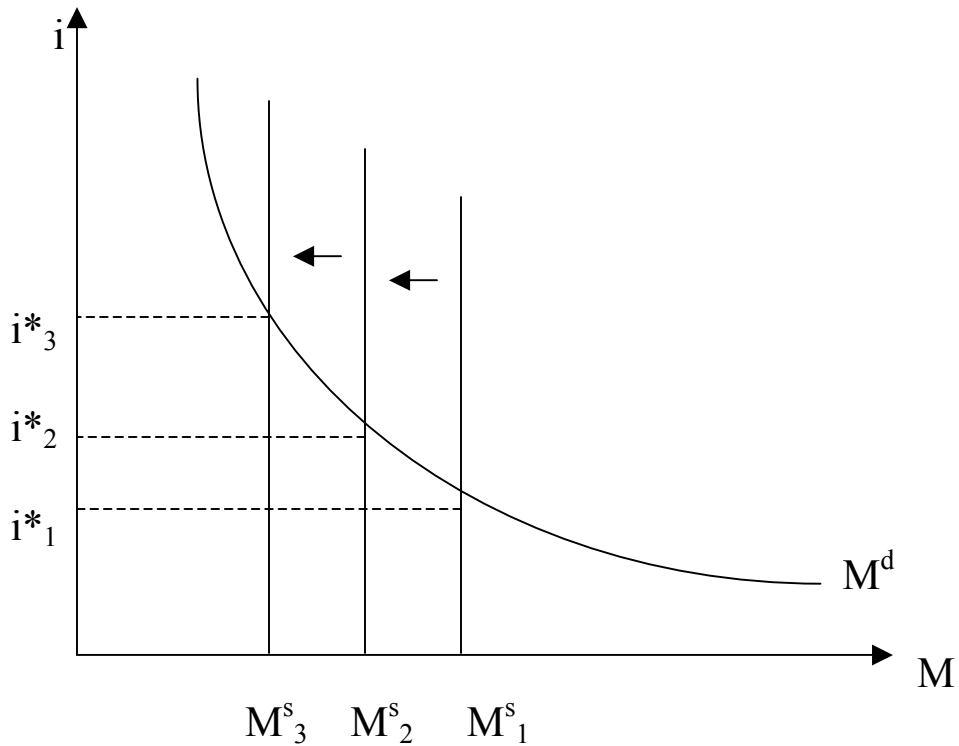


### Limits of KEMP:

1. The interest rate may be insensitive to changes in  $M_s$  (liquidity trap)
2. Investment may be insensitive to changes in interest rate (expectations of profitability are low, investor's uncertainty)
3.  $Y$  may be insensitive to changes in Investment (if  $Y=Y_f$ ; then increasing investment will cause a rise in the general price level (inflation); but KEMP wouldn't—or shouldn't—be used if  $Y=Y_f$ )

### Keynesian Anti-Inflationary Monetary Policy (KAIMP):

KAIMP:  $\downarrow M_s \rightarrow \uparrow i \rightarrow \downarrow I \rightarrow \downarrow P$  (if  $Y = Y_f$ )



### Limits of KAIMP:

1. KAIMP is only good for demand-pull inflation. If inflation is due to cost-push inflation or supply side factors, KAIMP is ineffective)
2. The Fed can overshoot the mark and cause investment to fall so much that there is a reduction in  $Y$  (thus causing a recession)