Macroeconomics

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Key Macroeconomic Issues

1. GDP Growth
2. Inflation
3. Budget (fiscal) Balance
4. Balance of Payment (trade) Balance
5. Exchange rate
6. Employment

Inflation targeting macro economic framework

Policy objective: reduce and maintain inflation in single digit

Main Policy Tool: Interest rate (Prime Rate)

Quantity Theory of Money

$$Mv = Py$$

M is money supply
v is velocity of money
P is price level
y is output

v and y are assumed to be constant; the neoclassical framework actually assumes full
Full employment
Increases in M can only have nominal effects – Price increases

Tight monetary policy standards designed to curb price inflation;

Fiscal policy subordinated to monetary policy (fiscal consolidation) in support of the disinflation objectives;

Fiscal policy within the framework of Washington Consensus

- Fiscal discipline, meaning an operational deficit of less than 1 to 2 percent of GDP, should be enforced.
- Deficits should be cut, preferably through expenditure reduction or by redirecting spending that interferes with markets – for example, subsidies – towards services that are 'proper objects of government expenditure', such as basic health and education.
- Whatever tax revenue is needed should come from a tax regime that is broad-based and has moderate marginal rates.