Macro Policies Cheat Sheet

Fiscal Policy
<u>Expansionary</u>
How it works:

- Through ↑G, ↓T ⇒ budget deficit (G > T)
- ↓T ⇒ ↑C, I
- ↑C, I, G ⇒ ↑AD ⇒ m.t.p. ↑ real NY
- ↑ real NY ⇒ ↓ cyclical UnN since labour is a derived demand
- ↑I, G in infrastructure ⇒ ↑ productive capacity in LR ⇒ ↑AS in LR
- ↑ real NY, ↑G in transfer payments ⇒ ↑mSOL
- ↑G on education/healthcare ⇒ ↑nmSOL

Limitations:

- **Crowding out effect as govt borrows from private sector ⇒ Lesser ↑ in AD
- ↑ national debt ⇒ Burden on future SOL
- Size of k multiplier
  - If small, large increase in G required to ↑ real NY to same extent
- Limited effectiveness of ↑G in Singapore's case as G contributes small proportion of Singapore's GDP
- Conflicts with other macro objectives
  - Inflation but unlikely to be significant
  - ↑C, some of which is imported ⇒ ↑M ⇒ ↓(X-M), ceteris paribus ⇒ Worsening BOP
- Time lag
- Imperfect info

<u>Contractionary</u>
How it works:

- Through ↓G, ↑T ⇒ budget surplus (G<T)
- ↑T ⇒ ↓C, I
- ↓C, I, G ⇒ ↓AD ⇒ ↓GPL ⇒ ↓DD-pull inflation
- ↓C, some of which is imported ⇒ ↓M ⇒ ↑(X-M), ceteris paribus ⇒ Improvement in BOP

Limitations:

- Difficulties in ↓G
    - ↓G in transfer payments ⇒ ↓mSOL of low income earners + ↓nmSOL due to ↓ social stability
    - ↓G in infrastructure ⇒ ↓PG
    - ↓G in healthcare, education ⇒ ↓nmSOL
    - Difficult to cut long term projects
- Difficulties in ↑T
    - ↓C ⇒ ↓mSOL
    - Politically unpopular
    - Brain drain
- Conflicts with other macro objectives
    - ↓AD may compromise some real NY and increase UnN assuming operating within intermediate range
- Does not address the root cause of cost-push inflation ⇒ Requires SS-side policies
- Small k value ⇒ ↑ opp cost
- Time lag
- Imperfect info

Interest Rate Policy

Expansionary

How it works:

- Through purchase of bonds in open market/decrease discount rate
- ↑ money supply ⇒ ↓i/r via direct and indirect transmission mechanism
- ↑C, I, (X-M) ⇒ ↑AD ⇒ m.t.p. ↑ real NY
- ↑ real NY ⇒ ↓ cyclical UnN since labour is a derived demand
- ↑I ⇒ ↑ productive capacity in LR ⇒ ↑AS in LR
- ↑(X-M) ⇒ Improvement in BOP

Limitations:

- Conflicts with other macro objectives
    - DD-pull inflation although unlikely to be significant
- Other factors play a role in influencing C and I
- Interest elasticity of demand for investment
    - Based on Keynesian argument, business confidence most important for I
- **Liquidity trap ⇒ Indirect mechanism ineffective if taken to the extreme
- Time lag
- Imperfect info

Contractionary

How it works:

- Through sale of bonds in open market/increase discount rate
- ↓ money supply ⇒ ↑i/r via indirect transmission mechanism
- ↓C, I, (X-M) ⇒ ↓AD ⇒ ↓GPL ⇒ ↓DD-pull inflation

Limitations:

- Conflicts with other macro objectives
    - ↓AD may compromise some real NY and increase UnN assuming operating within intermediate range
    - ↓I ⇒ ↓ productive capacity in LR ⇒ ↓AS in LR
    - ↓(X-M) ⇒ Worsening BOP
- Does not address the root cause of cost-push inflation ⇒ Requires SS-side policies
- Other factors play a role in influencing C and I
- Interest elasticity of demand for investment
- Time lag
- Imperfect info

Exchange Rate Policy
<u>Once-off Depreciation</u>
How it works:

- Through purchase of foreign currency using domestic currency
- ↑ supply of SGD ⇒ Depreciation of SGD
- ↑(X-M) assuming MLC is true ⇒ ↑AD ⇒ m.t.p. ↑ real NY
- ↑ real NY ⇒ ↓ cyclical UnN since labour is a derived demand
- ↑(X-M) ⇒ Improvement in BOP
- Accumulation of foreign reserves

Limitations:

- **Time lag as MLC may not hold in SR due to existing contracts making it difficult to reduce X or M (i.e. J curve effect)
- Conflicts with other macro objectives
    - **Import-push inflation (significant especially in Singapore) ⇒ Can only be used as a emergency measure in the SR ⇒ ↑COP
    - Price competitiveness of exports due to depreciation of SGD might be moderated due to ↑COP ⇒ ↑(X-M) may be moderated
    - ↑COP may moderate ↑I
- **Might invite retaliation by trading partners

- Imperfect info

<u>Appreciation</u>
How it works:

- Through purchase of SGD using foreign reserves
- ↑ DD for SGD ⇒ Appreciation of SGD
- ↓(X-M) ⇒ ↓AD ⇒ ↓GPL ⇒ ↓DD-pull inflation
- ↓ Import-push inflation
- ↓COP ⇒ ↑AS ⇒ ↓ cost-push inflation

Limitations:

- **Time lag as MLC may not hold in SR due to existing contracts making it difficult to reduce X or M (i.e. J curve effect)
- **Need to finance using foreign reserves ⇒ Depletion of foreign reserves ⇒ ↓ ability to support strength of currency in the future
- Conflicts with other macro objectives
  - ↓AD may compromise some real NY and increase UnN assuming operating within intermediate range
  - ↓(X-M) ⇒ Worsening BOP
- Imperfect info