- Interest rates take 18-24 months to have an effect on the economy

Factors considered when setting policy interest rates:
The Bank of England, sets policy interest rates which are consistent with the need to meet an inflation target of consumer price inflation of 2%.

1. GDP growth and spare capacity, estimates of output gap.
2. Bank lending, consumer credit figures, retail sales.
3. Equity markets (share prices) and house prices.
4. Consumer confidence and business confidence
5. Growth of wages, average earnings, labour productivity and unit labour costs, surveys on labour shortages
6. Unemployment and employment data, unfilled vacancies
7. Trends in global foreign exchange markets (ie is the sterling (the pound) appreciating or depreciating against other currencies)
8. International trade: eg growth rates in economies of major trading partners such as USA and the euro area

The Keynesian Liquidity Trap - where lowering interest rates and a high amount of cash balances in the economy fail to shift aggregate demand to right



Quantitative easing- supplying more money, cash or electronically, the bank uses that to buy assets, the currency becomes weaker (depreciates)
Quantitative easing is when the Bank of England increases the aggregate supply of money to support aggregate demand to avoid a depression. This stimulates spending in the economy, as there is more money in the economy. This causes inflation and an increase in standard of living as well as reducing unemployment.

By lowering the interest rates this will encourage people to borrow and spend money and discourage saving. In the short run this will raise aggregate demand, which will lead to a rise in the price level and a raise in GDP. This will allow the UK to come out of a recession and be able to economically grow. The more money consumers have will lead to an increase in their standard of living and hopefully firms will hire more as they have more profits. However this will create a balance of trade deficit as people will be buying more imports due to the inflation rising to meet the target and them having higher incomes. Inflation is beneficial in the short run. Aggregate demand's largest factor is consumer spending therefore if more households are spending the economy will grow.

In the long run this isn't sustainable due to the banks giving more money out and less coming in. This will result in the MPC lowering the rates to sustain inflation and growth however enough money remaining in the banks.