Research Title: The Relative Effectiveness of Monetary and Fiscal Policy on Macroeconomic Stability

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Abstract: Fiscal and monetary authorities mainly deal with macroeconomic stability. The study aims to understand links between monetary and fiscal policies with macroeconomic stability and to determine their relative effectiveness in general and relative importance of policy instruments in particular. We have used government total, current and development expenditures, government total and tax revenues and budget deficit represent fiscal policy instruments and interest rate and monetary growth rate from monetary side in our study. Our study is used Impulse Response functions and Variance Decompositions in Vector Autoregressive model. Our findings of impulse response analysis indicate that impact of Call Money Rate, Current Expenditures, Government Total Revenues and Tax Revenues is negative on Output Gap and Inflation rate while Monetary Growth Rate, Budget Deficit, Government Expenditures and Development Expenditures exert positive impact suggests that when positive output gap exist we should use tight monetary and fiscal policies to attain output and price stability and reverse should apply when output gap is negative. Whereas, increasing spending and tax cut stabilize external balance position at current level. Moreover, both policies are important for trade volume and foreign exchange reserves, strong fiscal stance for exchange rate stability and monetary dominance for output stability, price stability and current account balance position. Policy conflicts suggest that monetary instruments are useful for output and price stability whereas fiscal instruments are important for trade volume, foreign exchange reserves and exchange rate stability hence use of both instruments is an important policy combination for macroeconomic stability.