Quantity Theory, Inflation, and Money Demand

ECON 4673

Dr. Keen

Problems

1. How would you expect money velocity to behave over the short-run business cycle?

2. If credit cards were made illegal by congressional legislation, what would happen to the velocity of money? Briefly explain.

3. What three motives for holding money did Keynes consider in his liquidity preference theory of the demand for money? On the basis of these motives, what variables did he think determined the demand for money?

4. Suppose a plot of the values of the M2 money supply and nominal GDP over 40 years shows that these two variables move very closely together. In particular, a plot of the ratio of nominal GDP to the M2 money supply yields a very stable and easy-to-predict value for that ratio. Based on this evidence, would you recommend that the monetary authority conduct monetary policy by focusing mostly on the M2 money supply rather than on nominal interest rates? Briefly explain.

5. Calculate what happens to nominal GDP if the velocity of money remains constant at 5 and the money supply increases from $200 billion to $300 billion.

6. What happens to nominal GDP if the money supply grows by 20% but the velocity of money declines by30%?

7. If the velocity of money and aggregate output remain constant at 5 and $1,000 billion, respectively, what happens to the price level if the money supply declines from $400 billion to $300 billion?