More Rain Mon, Feb. 10: Tunis Tues, Feb. 11

- Fun Set 4.1 due NOW
- **Quiz next Tuesday/Wednesday over HW 4.1 and money demand graph (no tutorial this week)**
- *Learning target: I can explain monetary policy and the tools of the Federal Reserve.*
- Warm up: Answer the following questions regarding fiscal policy:
  1. What are the two main fiscal policy tools?
  2. Who conducts fiscal policy in the U.S.?
  3. What two fiscal policies would be used during a recession?
  4. What two fiscal policies would be used to fight inflation?
  5. Draw an AD/SRAS/LRAS graph showing a recession.
  6. On your graph in #5, draw the effect of expansionary fiscal policy.

Quiz Bowl

- Yigit, Alexa, Isabelle and Charlotte!

Agenda:

1. Warm up: Fiscal policy review (10 min)
2. Work period: Trade/grade FRQs; notes on monetary policy (55 min)
3. Closing: How is fiscal policy different from monetary policy? (5 min)

Fun set 4.1

TIME TO PRACTICE

2012 Audit Exam

3. The transaction demand for money is very closely associated with money's use as a

(A) store of value
(B) standard unit of account
(C) measure of value
(D) medium of exchange
(E) standard of deferred payment

2012 Audit Exam

12. The amount of money that the public wants to hold in the form of cash will

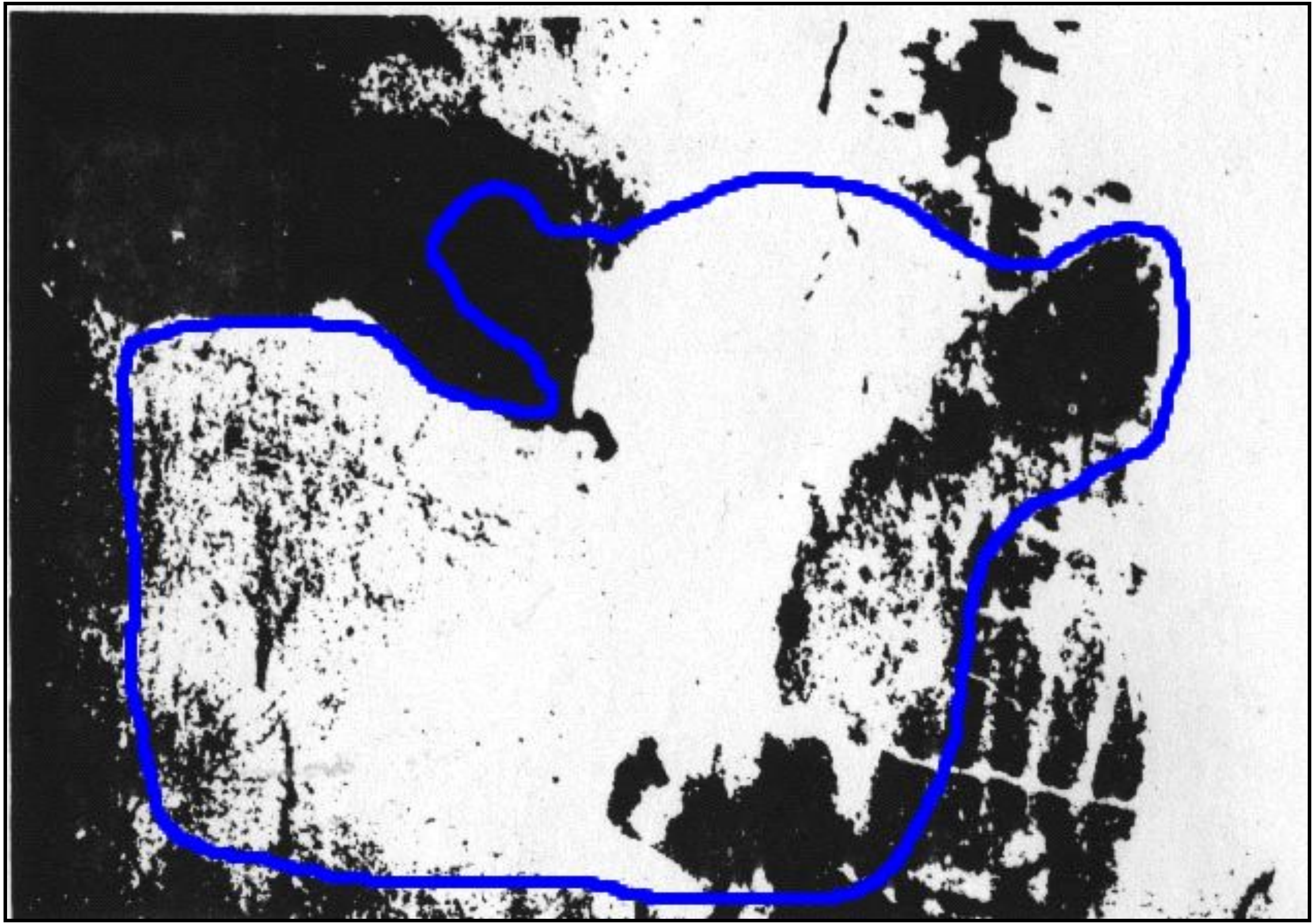
(A) be unaffected by any change in interest rates or the price level
(B) increase if interest rates increase
(C) decrease if interest rates increase
(D) increase if the price level decreases
(E) decrease if the price level remains constant

TIME TO PRACTICE

2008 Audit Exam

3. With a constant money supply, if the demand for money decreases, the equilibrium interest rate and quantity of money will change in which of the following ways?

	Interest Rate	Quantity of Money
(A)	Increase	Decrease
(B)	Increase	Not change
(C)	Decrease	Decrease
(D)	Decrease	Increase
(E)	Decrease	Not change



2007B Practice FRQ

1. Assume that Australia and New Zealand are trading partners. Australia's economy is currently in recession.

   (a) Now assume that Australia begins to recover from its recession. Using a correctly labeled graph of aggregate demand and aggregate supply for New Zealand, show the impact of Australia's rising income on each of the following in the short run.

      (i) Aggregate demand in New Zealand. Explain.

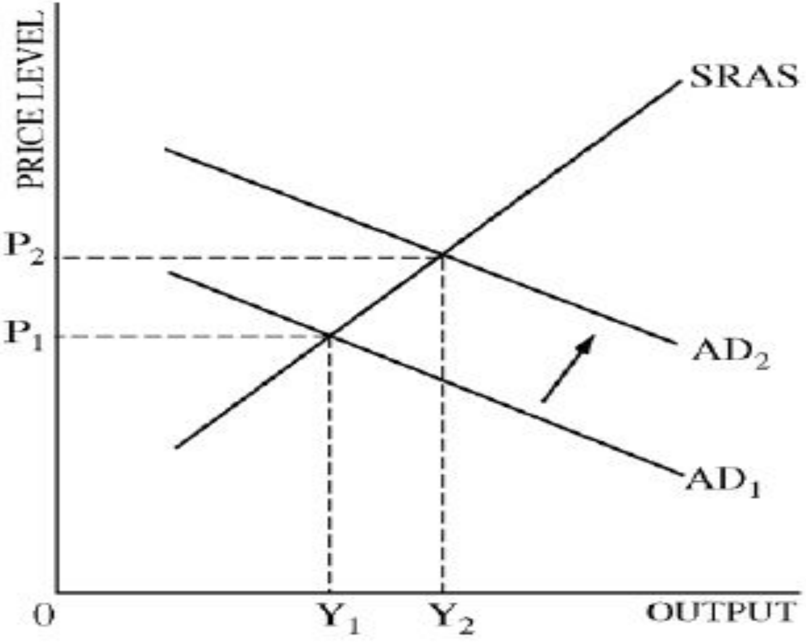
      (ii) Output in New Zealand

   (b) Using a correctly labeled graph of the money market for New Zealand, show the effect of the output change in part (a)(ii) on the following.

      (i) Demand for money. Explain.

      (ii) The nominal interest rate

2007B Practice FRQ



(a) 4 points:

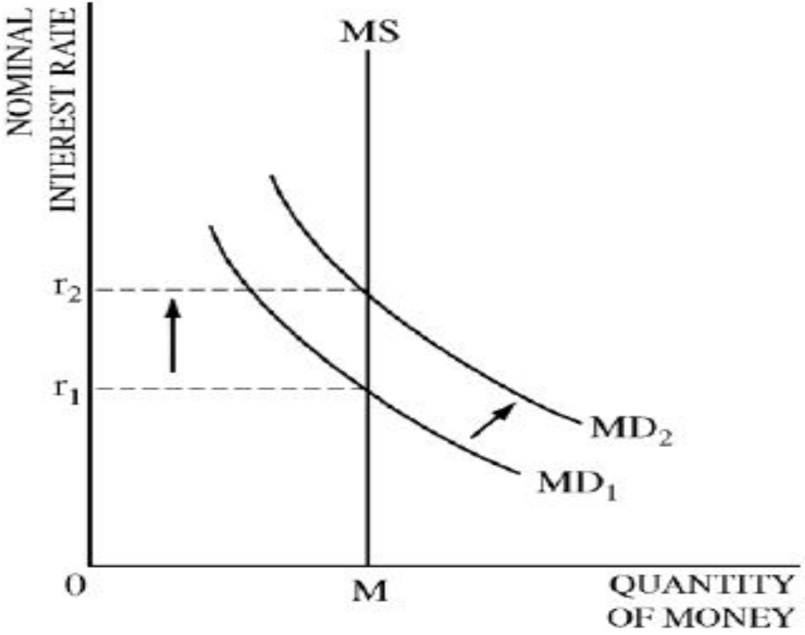
One point is earned for a correctly labeled graph.

One point is earned for showing a rightward shift in New Zealand's AD curve.

One point is earned for the explanation that New Zealand's exports to Australia increase.

One point is earned for concluding that New Zealand's output increases.

2007B Practice FRQ



(b) 4 points:

One point is earned for a correctly labeled graph of the money market.

One point is earned for showing a rightward shift of the money demand curve.

One point is earned for the explanation that higher income means more volume of transactions.

One point is earned for concluding that the nominal interest rate increases.

2. Assume that an economy is in long-run equilibrium. Assume that consumers wish to hold less money because they use credit cards more frequently to purchase goods and services than cash.

   (a) Draw a correctly labeled graph of the money market and show the effect of the reduced holdings of money on the equilibrium nominal interest rate in the short run.

   (b) Based on the change in the interest rate in part (a), what will happen to each of the following in the short run?

      (i) Prices of previously issued bonds

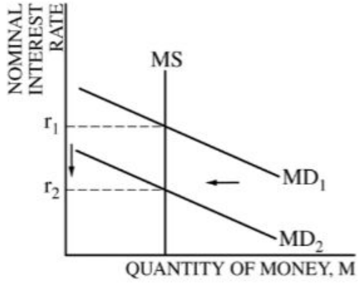
      (ii) The price level and real income. Explain.

   (c) With a constant money supply, based on your answer to part b(ii), will the velocity of money increase, decrease, or remain the same, or is the change indeterminate?

   (d) If the central bank wishes to reverse the change in the interest rate identified in part (a), what open market operation would it use?

Question 2

6 points (2 + 2 +1 + 1)



(a) 2 points:

- One point is earned for drawing a correctly labeled graph of the money market.
- One point is earned for showing a leftward shift in the money demand curve, resulting in a lower nominal interest rate.

(b) 2 points:

- One point is earned for stating that the price of previously issued bonds will increase.
- One point is earned for stating that both the price level and real income will increase and for explaining that the lower interest rate will increase consumption, investment, and/or net exports (interest-sensitive spending), which increases aggregate demand.

(c) 1 point:

- One point is earned for stating that the velocity of money will increase.

(d) 1 point:

- One point is earned for stating that the central bank would sell bonds.

MACROECONOMICS

Section II

Planning Time—10 minutes

Writing Time—50 minutes

Directions: You have 50 minutes to answer all three of the following questions. <u>It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions</u>. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. <u>Use a pen with black or dark blue ink</u>.

1. Assume that declining stock market prices in the United States cause many United States financial investors to sell their stocks and increase their money holdings.

   (a) Draw a correctly labeled graph of the money market and show the impact of the financial investors' actions on each of the following.

      (i) Demand for money

      (ii) Nominal interest rate

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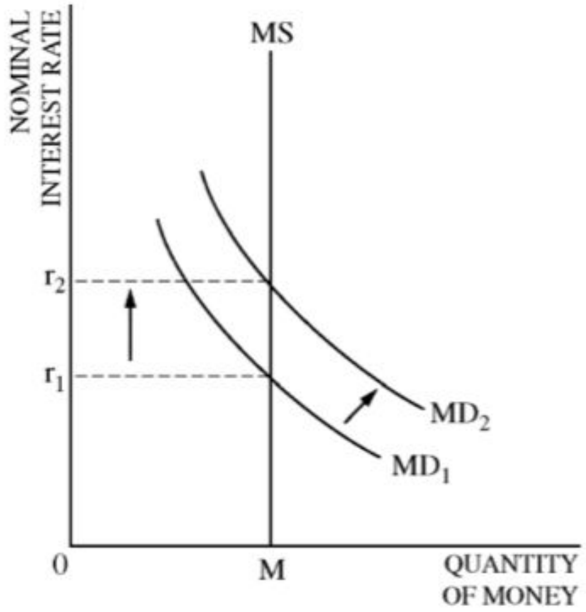
Question 1

12 Points (3 + 3 + 2 + 3 +1)



(a) 3 points:

- One point is earned for a correctly labeled graph of the money market.
- One point is earned for showing a rightward shift of the money demand curve.
- One point is earned for the conclusion that the interest rate rises .

Washy Wed, Feb. 12~Thirsty Thurs, Feb. 13

- **Quiz next week over HW 4.1, money demand graph and today's content (no tutorial this week)**
- Warm up: Write the question and complete correct answer in your notes:
- "The price for a ticket to the Super Bowl is $500." This shows money as a

  A. Liability

  B. Liquid asset

  C. Unit of account

  D. Medium of exchange

  E. Store of value
- *Learning target: I can explain the relationship between the money supply and interest rates; I can explain the importance of interest rates and interest-sensitive spending on C, I and AD. I can explain the reserve requirement and the money multiplier as a tool of the Federal Reserve.*

Agenda:

1. Warm up: Roles of money (5 min)
2. Work period: Notes on monetary policy; HW 4-2 (55 min)
3. Closing: How is fiscal policy different from monetary policy? (5 min)

Unit 4: Money, Banking, and Monetary Policy

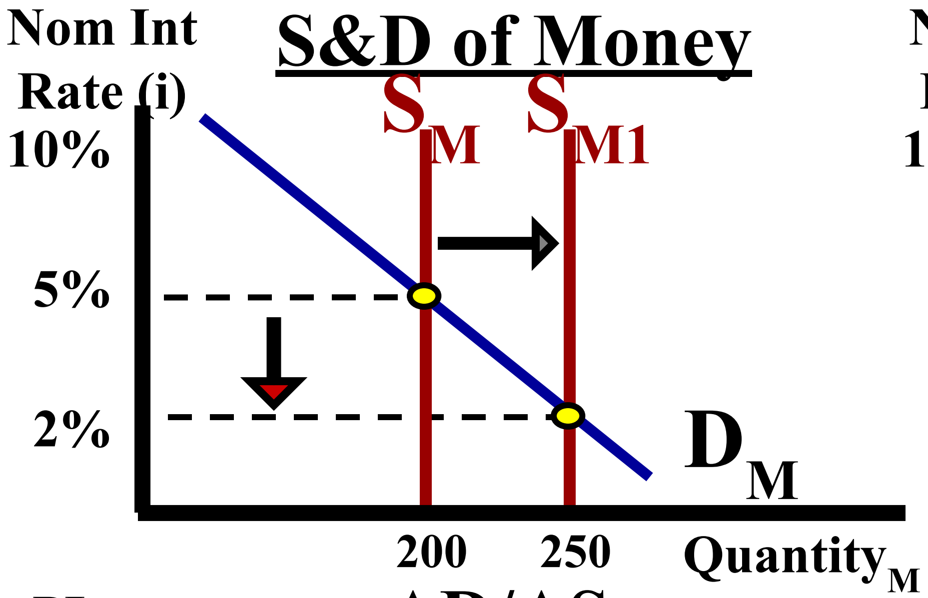
“Monetary Base” or M0

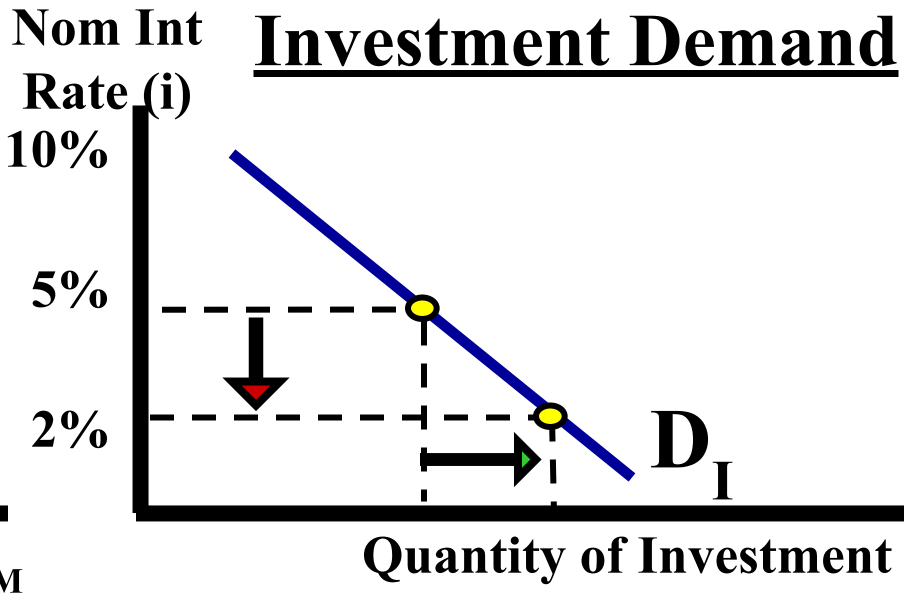
The monetary base (M0 or MB) includes currency in circulation and bank reserves.

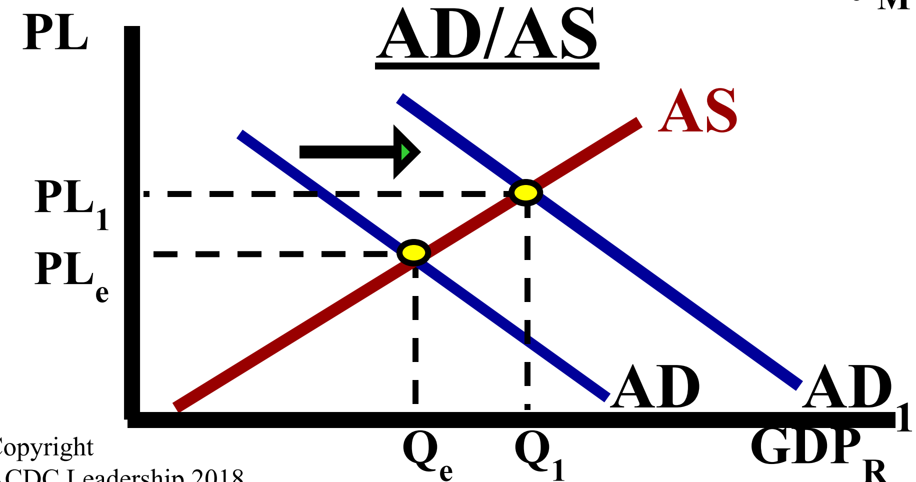
How does a change in the money supply affect the economy?

Three Related Graphs:

- **Money Market**
- **Investment Demand**
- **AD/AS**

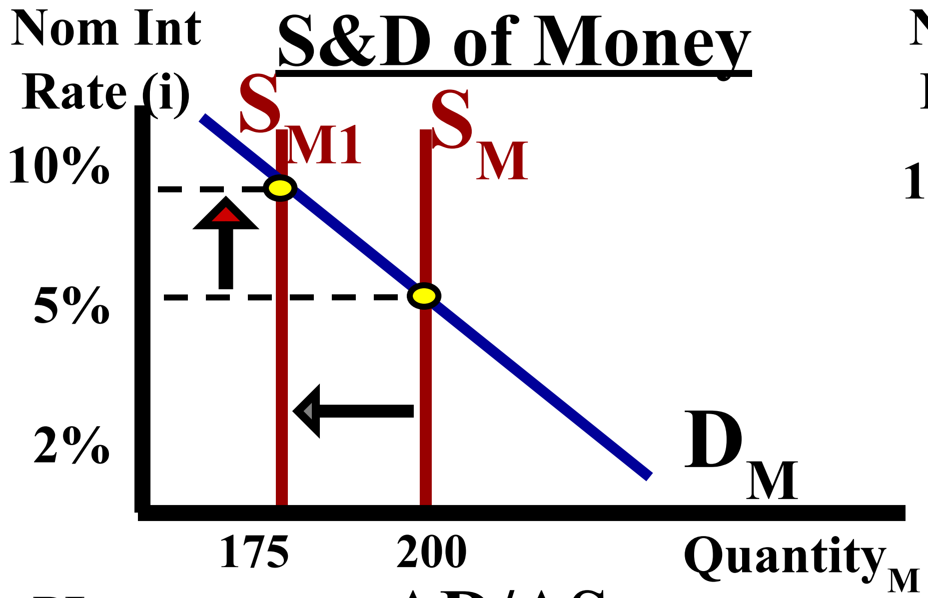


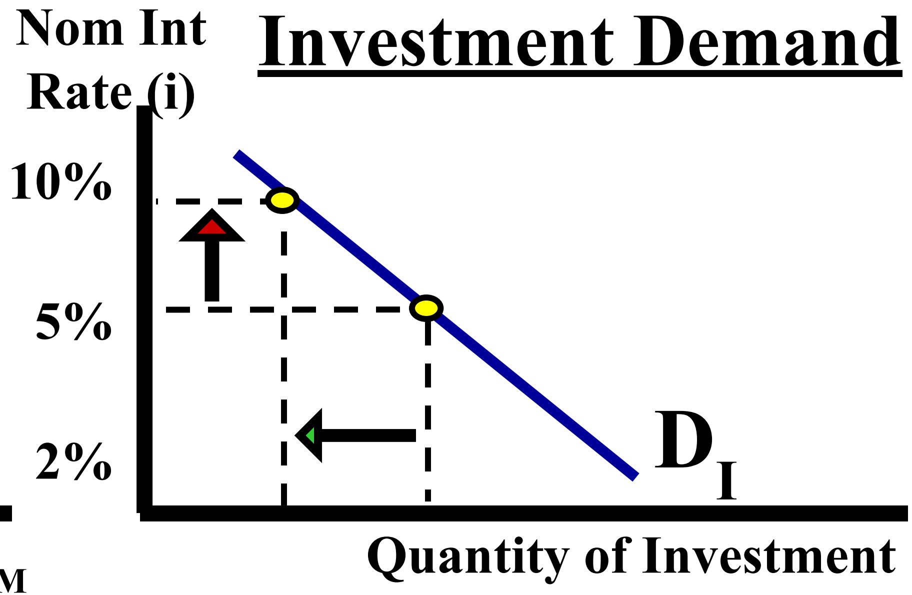


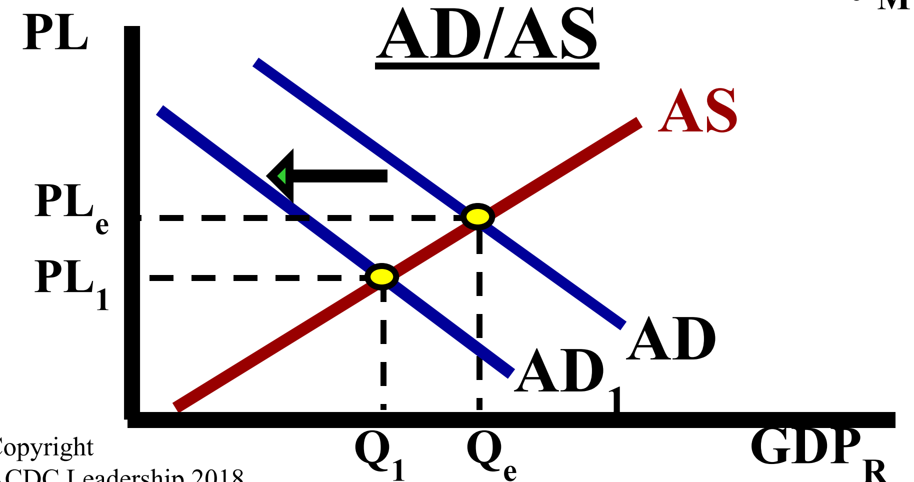


The Fed increases the money supply to stimulate economy in a recessionary gap…

1. Interest Rates Decreases
2. Investment Increases
3. AD, GDP and PL Increases







The Fed decreases the money supply to slow down economy in inflationary gap …

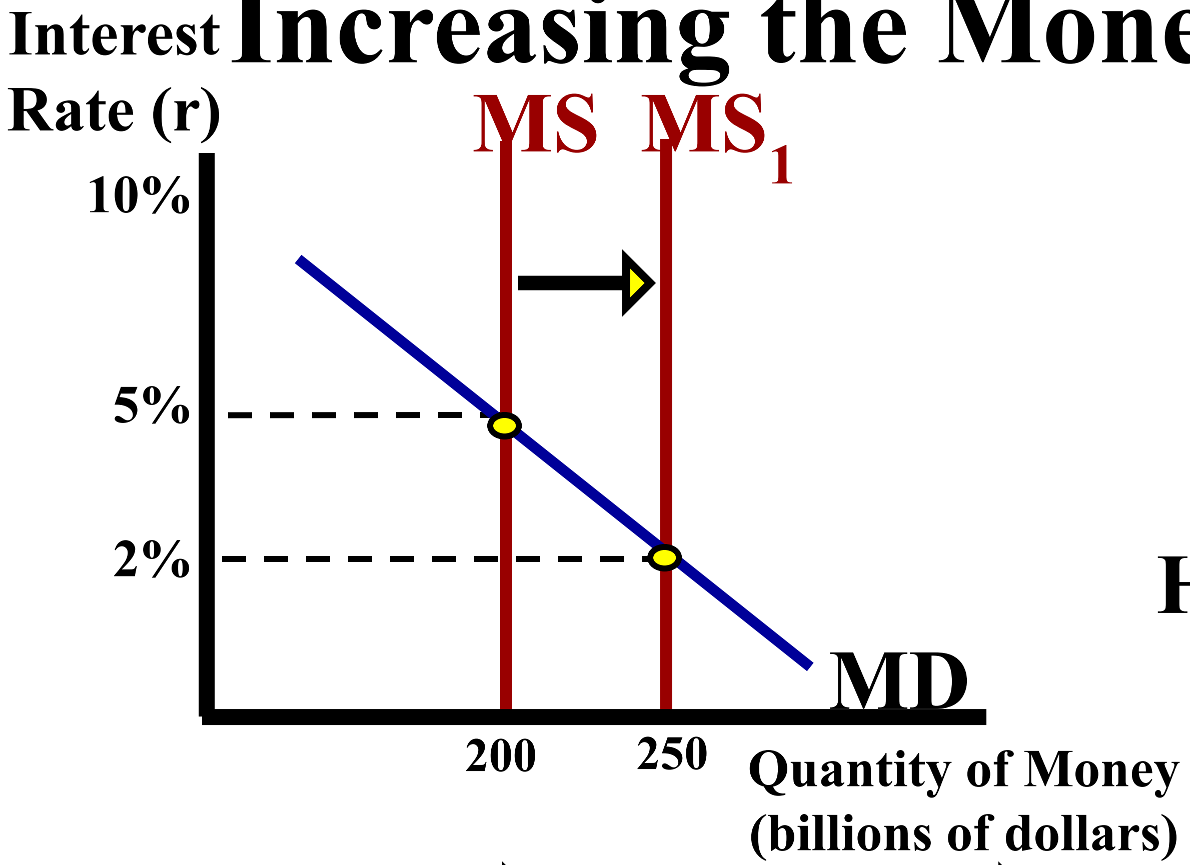
1. Interest Rates increase
2. Investment decreases
3. AD, GDP and PL decrease

Wait, why would the Fed ever want to slow down the economy?

To fight inflation!

The role of the Fed is to "take away the punch bowl just as the party gets going".

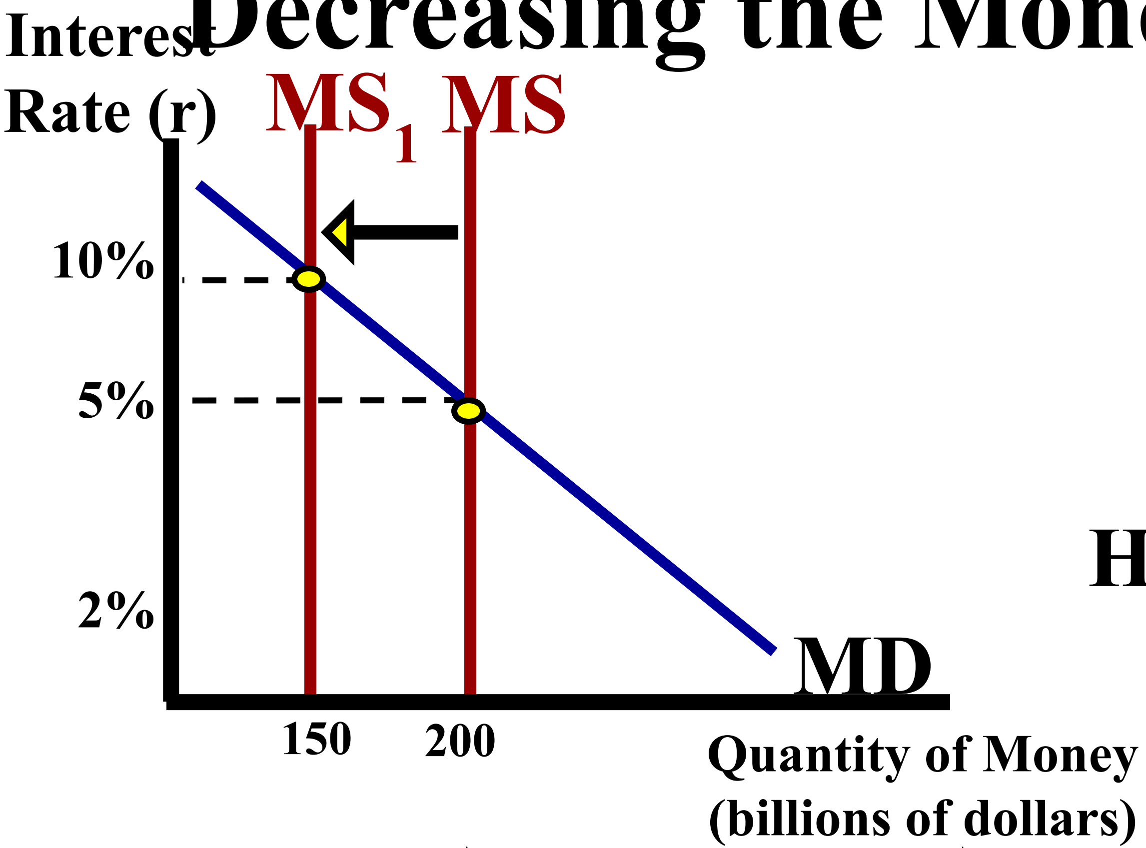
Increasing the Money Supply



How does this affect AD?

Increase money supply → Decreases interest rate → Increases investment → Increases AD

Decreasing the Money Supply



How does this affect AD?

Decrease money supply → Increase interest rate → Decrease investment → Decrease AD

HW 4-2: Read chapter 29 in Mankiew, then complete questions for review 1-9.