Name & SID: Date:

Assumptions are critical in macroeconomics. Different assumptions change dramatically your answers. Assume the following conditions for the following questions:

- Closed economy (NX=0)
- Planned investment is NOT autonomous of interest rates. Planned investment is a function of interest rates.
- Y refers to real GDP (not nominal)
- ASSUME THE FED USES A **MONEY SUPPLY TARGET** (PLEASE REFER TO HANDOUT ABOUT THE DIFFERENCES BETWEEN A MONEY SUPPLY TARGET AND INTEREST RATE TARGET).

---

1. What is *money*? And can it grow on trees?

2. What is the difference between a liquid asset and an illiquid asset?

3. Define *interest rate* from at least two perspectives.

4. Does money earn interest?

5. Explain what is misleading about these statements: *I want lots of money; in fact, I want to have as much money as possible. Therefore my money demand is very high or infinite because I can never have enough money.*

Name & SID: Date:

6. Explain why money demand ($M^d$) is downward sloping.

7. Graph money demand. Label $M^d$.

8. Interest rates (r) rise. What happens to money demand? Explain. Show graphically in question 7. Label anything new with a subscript *a*.

9. Price level falls. What happens to money demand? Explain. Show graphically in question 7. Label anything new with a subscript *b*.

10. Aggregate output (Y) rises. What happens to money demand? Explain. Show graphically in question 7. Label anything new with a subscript *c*.

11. Explain why money supply ($M^S$) is a vertical line.

Name & SID: Date:

12. Graph money demand ($M^d$) and money supply ($M^S$). Label the equilibrium interest rate, r*.

13. Who has the ability to change the money supply?

14. The Fed raises the required reserve requirement. How does this affect money supply? Interest rates? Explain. Show graphically in question 12. Label anything new with a subscript *a*.

15. The Fed lowers the discount rate. How does this affect money supply? Interest rates? Explain. Show graphically in question 12. Label anything new with a subscript *b*.

16. The Fed buys securities (or "bonds). How does this affect money supply? Interest rates? Explain. Show graphically in question 12. Label anything new with a subscript *c*.

17. The Fed sells securities (or "bonds). How does this affect money supply? Interest rates? Explain. Show graphically in question 12. Label anything new with a subscript *d*.