AP Macroeconomics: Objective 4.8-10 Practice

1. Use the Quantity Theory of Money to answer the following:

   a) Assume that the nominal GDP is $1,500 and the money supply is $500, what is the velocity of money?
   b) If the velocity remains stable, but the money supply doubles, what will happen to nominal GDP?

2. Use the Fisher Effect to answer the following:

   a) If the nominal interest rate is 7% and the inflation rate is 3%, what is the real rate of interest?
   b) If the inflation rate increases, how will the nominal interest rate be affected? The real interest rate?
   c) If the real interest rate is 3% and the inflation rate is 2%, what is the nominal interest rate?

3. For <u>each</u> of the following examples, start by drawing a correctly labeled graph of the money market at equilibrium.

   a) Assume there is a decrease in price level. On your graph, show and explain the effects of this on nominal interest rates and the quantity of money.
   b) Assume the Fed decides to sell bonds. On your graph, show and explain the effects of this on nominal interest rates and the quantity of money.

4. Draw a correctly labeled graph of the aggregate model for an economy operating at less than full employment.

   a) What monetary policy action could the Fed take to return the economy to full employment? Explain.
   b) Draw the effects of this monetary policy action on the graph. Explain what shifted and why.