AP MACROECONOMICS • EXERCISE SHEET

5.3 Money Growth and Inflation

Name: ______________ Class: __________ Date: ____________ **Total: 8 marks**

Objective

Build the skills to answer exam questions on **money growth and inflation**.

You must be able to:

- state the **quantity theory of money** 货币数量论, $MV = PQ$
- explain how excessive **money-supply growth** causes inflation in the long run
- describe the long-run **neutrality of money** 货币中性

1 Worked examples

Study these first. Each one shows the method for a question type used later.

■ **The quantity theory**

$$MV = PQ,$$

money supply × velocity = price level × real output.

■ **Money growth and inflation**

If V and Q are roughly stable, then raising M mainly raises P —persistent excessive money growth causes **inflation**.

■ **Neutrality of money**

In the **long run**, money growth changes only **prices**, not real output or employment.

2 Practice

2.1 State the equation of the quantity theory of money. [1]

2.2 State the long-run effect of rapid money-supply growth. [1]

2.3 Explain what is meant by the neutrality of money. [2]

3 Exam-style questions

3.1 The quantity theory of money is [1]

- **A** $MV = PQ$
- **B** $GDP = C + I + G$
- **C** $V = IR$
- **D** $MPC + MPS = 1$

3.2 In the long run, an increase in the money supply mainly raises [1]

- **A** real output
- **B** the price level
- **C** employment
- **D** productivity

3.3 A country doubles its money supply over a few years, while velocity and real output stay roughly constant.

(a) State the effect on the price level. [1]

(b) Name the principle that money affects only prices, not real output, in the long run. [1]

4 Go further

- work through the **5.3 Money Growth and Inflation** lesson on the **Learn** page;
- read the **Long-Run Consequences of Stabilization Policies** section of the AP Macroeconomics handout on the **Know** page.

Solutions

2.1 $MV = PQ$.

2.2 it causes inflation (a rise in the price level).

2.3 in the long run a change in the money supply changes the price level but not real output or employment.

3.1 **A**.

3.2 **B**.

3.3 (a) it roughly doubles (the price level rises). (b) the neutrality of money.