

5.3 Money Growth and Inflation

Name: _____ Class: _____ Date: _____ **Total: 8 marks**

KEY WORDS neutrality of money 货币中性 • quantity theory of money 货币数量论
• productivity 生产率

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 $\times$ velocity = price level $\times$ 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]

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.