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 × 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 B
C D

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 B
C D

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]