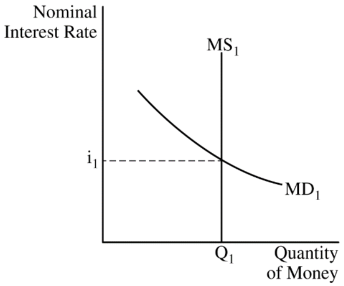
Question 2: Short	**5 points**

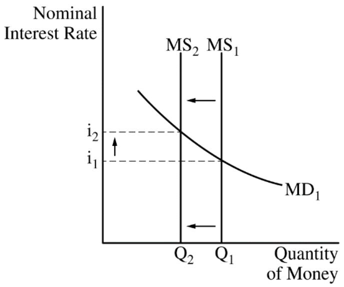
(a) Calculate the maximum change in the money supply as a decrease of $500,000 and show your work. **1 point**

$$\text{Change in MS} = \text{Bond Sale} \times \text{Money Multiplier} = -\$100{,}000 \times \frac{1}{0.2} = -\$500{,}000$$

(b) Draw a correctly labeled graph of the money market. **1 point**



For the second point, the graph must show a leftward shift in the money supply curve, resulting in a higher nominal interest rate. **1 point**



Total for part (b) 2 points

(c) State that nominal gross domestic product will decrease and explain that according to the quantity theory of money (MV=PY), a decrease in the money supply will decrease nominal gross domestic product for a given velocity. **1 point**

(d) State that the price level decreases. **1 point**

Total for question 2 5 points

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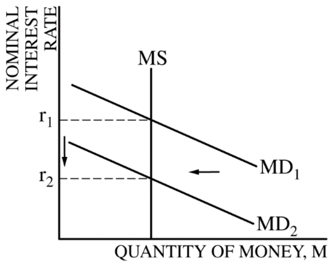
Question 2

6 points (2 + 2 +1 + 1)



(a) 2 points:

- One point is earned for drawing a correctly labeled graph of the money market.
- One point is earned for showing a leftward shift in the money demand curve, resulting in a lower nominal interest rate.

(b) 2 points:

- One point is earned for stating that the price of previously issued bonds will increase.
- One point is earned for stating that both the price level and real income will increase and for explaining that the lower interest rate will increase consumption, investment, and/or net exports (interest-sensitive spending), which increases aggregate demand.

(c) 1 point:

- One point is earned for stating that the velocity of money will increase.

(d) 1 point:

- One point is earned for stating that the central bank would sell bonds.