CONCEPT: OVERVIEW OF THE MONETARIST MODEL

● The ***monetarist model of economics*** argues that Keynesian economics overstated the instability in the economy

- □ Developed by Milton Friedman, a Nobel Prize winning economist, in the 1940s
- □ Basis of monetarism:
  - > Primary focus on the ________________
  - > Competitive market system leads to a high degree of stability
- □ Monetary policy focuses on the ***quantity theory of money:***
  - - ***Quantity Theory of Money*** – a theory that connects the money supply with the level of prices

$$Money\ Supply * Velocity\ of\ Money = Price\ Level * Real\ GDP$$

  - - The velocity of money is assumed to be stable by monetarists
  - - Steady increases in the money supply would ensure steady growth in spending and GDP
- □ In the real world, the velocity of money is not stable enough
  - - Monetarism strongly influenced monetary policy in the late 1970s and early 1980s
  - - Inflation soared during this period, leading to believe monetarism was flawed