CONCEPT: QUANTITY THEORY OF MONEY

● ***Quantity Theory of Money*** – a theory that connects the money supply with the level of prices

$$M * V = P * Y$$

□ M = ______________

□ V = ______________ → average number of times each dollar of the money supply is spent

□ P = ______________

□ Y = ______________

EXAMPLE: In 2014, the money supply equaled $2.8 trillion, while real GDP totaled $16 trillion and the GDP price deflator was 1.09. Calculate the velocity of money using the quantity theory of money.

● The quantity theory of money argues that the velocity of money is constant

□ The average times a dollar is spent depends on factors that do not change often

> How often you get paid, how often you grocery shop, how often you mail your bills

□ A mathematical rule allows us to use the equation above (M x V = P x Y) to analyze inflation

$$\Delta M + \Delta V = \Delta P + \Delta Y$$

> If the money supply grows faster than real GDP, then there will be ______________

> If the money supply grows slower than real GDP, then there will be ______________

> If the money supply grows at the same rate as real GDP, then there will be ______________