# Interest Rates in the Long Run

1. Draw a money market graph showing equilibrium interest rate (r1) and equilibrium quantity (QM1).

1. Using the money market graph you drew in question 1, show and explain what will happen to equilibrium interest rate if the money supply increases by 10%?
2. According to money neutrality, how will this change in the money supply impact the long run aggregate price level?
3. Using the money market graph you drew in question 1, show and explain why the price level you identified in question 3 will impact the money market.

# Interest Rates in the Long Run Answer Key

* 1. Draw a money market graph showing equilibrium interest rate (r1) and equilibrium quantity (QM1).

*Question 1 Graph Question 2 Graph Question 4 Graph*

* 1. Using the money market graph you drew in question 1, show and explain what will happen to equilibrium interest rate if the money supply increases by 10%?

*If the money supply increases by 10%, the short-run interest rate falls.*

* 1. According to money neutrality, how will this change in the money supply impact the long run aggregate price level?

*According to money neutrality, the aggregate price level rises by 10% in the long-run.*

* 1. Using the money market graph you drew in question 1, show and explain why the price level you identified in question 3 will impact the money market.

*When aggregate prices rise by 10%, households will increase their demand for money by 10%. When money supply and demand shift to the right by 10%, the long-run equilibrium interest rate returns to r1.*