# Monetary Policy in the Short and Long Run

Fully answer each of the following questions.

1. Assume an economy is in long-run equilibrium.
   1. Draw a correctly labeled graph of aggregate demand and supply of this economy.
   2. Draw a correctly labeled graph of equilibrium in the money market.
   3. On your graph in part (b), show what happens to the money market in the short run if the central bank decreases the money supply.
   4. On your graph in part (a), show what happens to the macroeconomy in the short run if the central bank decreases the money supply.
   5. On both graphs, show what will happen in the long run. Explain these adjustments.



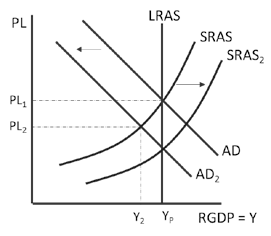
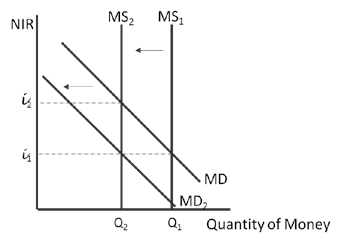
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# Monetary Policy in the Short and Long Run Answer Key

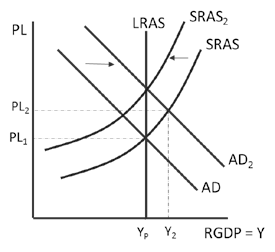
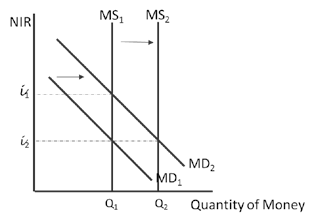
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1. *In the long run, the increase in wages will increase the costs of production decreasing short- run aggregate supply to the original potential output at a higher price level (AD2–SRAS2). In addition, higher prices lead to more demand for money, increasing the nominal interest rate to its original level.*