# 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.

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 increases the money supply.
	4. On your graph in part (a), show what happens to the macroeconomy in the short run if the central bank increases the money supply.
	5. On both graphs, show what will happen in the long run. Explain these adjustments.


# Monetary Policy in the Short and Long Run Answer Key

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.

 

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

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 increases the money supply.
	4. On your graph in part (a), show what happens to the macroeconomy in the short run if the central bank increases the money supply.
	5. On both graphs, show what will happen in the long run. Explain these adjustments.

 

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.*