

Place your name on the back of this sheet of paper and nowhere else. Staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (25 points) Explain  $M^d = f(P, Y, \pi^e, i^M, r)$ . (Note that I could put this on a test adding other variables like risk of other assets, liquidity of other assets, etc.)
- 2) (15 points) The velocity of money for M1,  $V1$ , started to become unstable in the 1980s and is still unstable. Referencing the items in M1 and M2, explain how interest changes can cause  $V1$  to become unstable, but not the velocity of M2,  $V2$ .
- 3) (15 points) Which category of money, M1 or M2, should work best with our theories of spending? Explain your logic.
- 4) (15 points) Explain why some economists say that inflation is a monetary phenomenon.
- 5) (10 points) In a later chapter, we will be drawing a money supply/demand diagram. What will go on the vertical axis? Why does that go there?
- 6) (10 points each) For each of the following, explain how it affects the demand for money.
  - A) Suppose stocks become more liquid.
  - B) People's wealth increases.