

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up 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) (15 points) Explain  $\pi = \frac{\Delta M}{M} - r_k \frac{\Delta Y}{Y}$

2) (10 points each) For each event, explain how it affects money demand and the reason it has that effect.

- A) Inflation is expected to increase.
- B) The price level is higher.
- C) The efficiency of payments systems improves.
- D) Other assets become more liquid.
- E) Your wealth increases.

3) (15 points) Use the *quantity theory of money* to explain why some economists say that inflation is a *monetary phenomenon*.

4) (20 points) Explain why the velocity of money may not be constant. Why do we care whether or not it is constant?