

ECONOMICS USA

THE EQUATION OF EXCHANGE

Money Matters! The economic idea behind the Fed's actions is that the money supply influences output and prices. The relationship between money supply and GNP is expressed by the *Equation of Exchange*:



M = _____ P = _____

V = _____ Q = _____

Express in your own words what the Equation means: _____

1. If $M = \$200$, $V = 4$, $P = \$2$ and $Q = 400$,
 $M \times V = P \times Q =$ _____.
2. If $M = \$400$, $V = 4$, $Q = 400$, what happens to prices (P) when the money supply doubles?
State a conclusion: _____
3. Assume now $M = \$400$, $Q = 400$, V drops to 2. What happens to P ?
State a conclusion: _____
4. Assume now $M = \$400$, $v = 4$, but $Q = 800$. What happens to P ?
State a conclusion: _____