

ECO 400: Monetary Theory and Policy

Instructor: Murray, James

Take Home Exam 1

Due Wednesday, October 14 at 11:00am. Late exams will earn zero credit.

Directions: Answer the following questions on separate sheets of paper. Start each answer on its own sheet of paper. All answers must be very neat and very clearly legible. If it is difficult to read an answer, no credit will be given.

Rules: *You must not work together on this exam with any other person.* You may however, discuss this exam with others if nobody in the conversation has any class materials in front of them, and no one is writing anything down. That is, you may discuss the exam in casual conversations, but you must still work on the exam independently. Failure to comply with this condition is considered academic dishonesty and will result in the harshest penalty that the university will allow. You are allowed to use your notes, textbook, and computer.

1. (15 points) State the conclusion of the quantity theory of money. On what assumptions do these conclusions rest? Provide a criticism of each assumption.
2. (15 points) In the Portfolio Balance Model, what effect does an increase in wealth have on the optimal quantity of bond holdings and money holdings. Many would argue this is not a reasonable conclusion. What part of the model would have to be altered and how should it be altered to deliver a more reasonable outcome?
3. (25 points) Name six factors that can shift a money demand function. For each factor, completely explain how the factor shifts the money demand function. A complete description should include a description of the appropriate model, graphs appropriate to the model, and intuitive explanations.
4. (15 points) What factor(s) influence elasticity of money demand in the portfolio balance model? Describe this effect using the appropriate graphs, equations, and intuitive explanations.
5. (15 points) What factor(s) influence elasticity of money demand in the precautionary money demand model (where money is demanded for the purpose of purchasing goods). Describe this effect using the appropriate graphs and intuitive explanations.
6. (15 points) Craig and Rocheteau (2005) suggest that there are positive externalities to holding money. Describe their reasoning for why this might be so. What are the implications for the welfare cost of inflation?