The Money Market

Class Activity

EQUILIBRIUM IN THE MONEY MARKET

If the money market is currently operating at the "Equilibrium" point in the graph below, how will the following headlines affect equilibrium? First, determine if demand, supply, the interest rate, and quantity "Increase," "Decrease," or exhibit "No Change." Then, write in the letter of the new equilibrium point.

1) Inflation Hits the Economy

Demand: ______________
Supply: ______________
Interest Rate: ______________
Quantity: ______________
New Equilibrium Point: _______

2) Recession Shakes Consumer Confidence

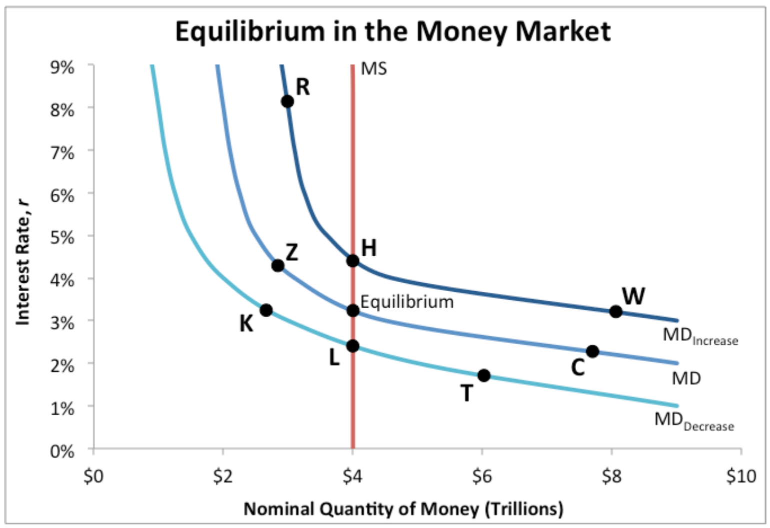
Demand: ______________
Supply: ______________
Interest Rate: ______________
Quantity: ______________
New Equilibrium Point: _______

3) Interest Rate Target Lowered

Demand: ______________
Supply: ______________
Interest Rate: ______________
Quantity: ______________
New Equilibrium Point: _______

4) Federal Reserve Sells T-Bills

Demand: ______________
Supply: ______________
Interest Rate: ______________
Quantity: ______________
New Equilibrium Point: _______



REAL MONEY DEMAND

These are the factors that cause real money demand to change. For each headline, circle whether there is an "Increase" or a "Decrease" in demand, and indicate which "Factor" caused demand to change.

A	B	C	D	E
Consumer Spending	Technology	Financial Innovation	Precautionary Motives	International Factors

5) Foreigners Seek More U.S. Dollars

Increase Decrease Factor: ___

6) Withdrawal Limits for ATMs Removed

Increase Decrease Factor: ___

7) Officials Say a Recession Is Coming Soon

Increase Decrease Factor: ___

8) Black Friday Holiday Shopping Is Here

Increase Decrease Factor: ___

9) Online Stores Now Accept Credit Cards

Increase Decrease Factor: ___

10) New Government Budget Bigger Than Ever

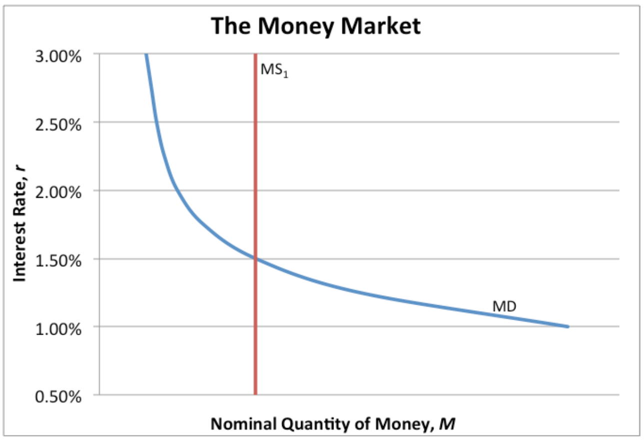
Increase Decrease Factor: ___

SETTING THE FEDERAL FUNDS RATE

Two actual statements released by the Federal Reserve are listed below. Under each one, there is a money market graph in equilibrium prior to the release date. Use the graphs to illustrate how the money market will change based on each statement, and then answer the questions.

Release Date: September 21, 2004

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points, from 1.50 to 1.75 percent.



11) Draw the change in the money market on the graph.

12) Which open-market operation should the Federal Reserve engage in to achieve this policy objective? How would this open-market operation affect the money market?

13) How will the interest rate and the quantity of money in the economy change?

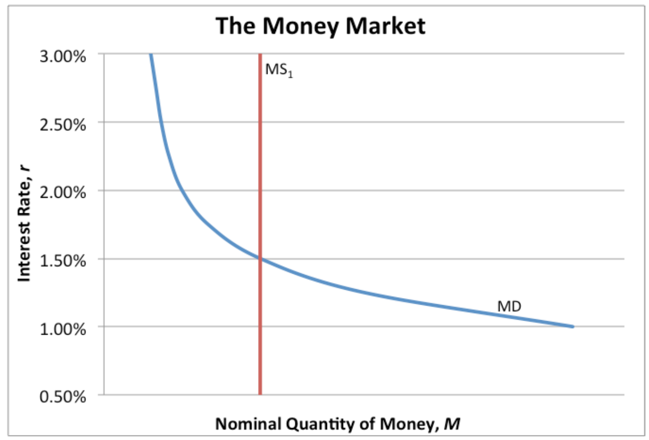
Interest Rate: ______________________

Quantity: ______________________

14) Even though the Federal Reserve only controls the federal funds rate, how is it able to exert influence over the entire economy?

Release Date: October 29, 2008

The Federal Open Market Committee decided today to lower its target for the federal funds rate by 50 basis points, from 1.50 to 1.00 percent.



15) Draw the change in the money market on the graph.

16) Which open-market operation should the Federal Reserve engage in to achieve this policy objective? How would this open-market operation affect the money market?

17) How will the interest rate and the quantity of money in the economy change?

Interest Rate: ______________________

Quantity: ______________________

18) Do you think a lowering of the target federal funds rate signifies the economy is in an expansion, or that it is in a recession? Explain your reasoning.