DISCUSSION QUESTION

Name:
Instructor:
Course:

Discuss how the Federal Reserve conducts expansionary monetary policy. What are some other names used to identify expansionary monetary policy?

PEER GROUP PROBLEM SOLVING

Name:
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Course:

Classical theory supports the quantity theory of money which is defined by the Equation of Exchange. What is it and how does it work?

IN-CLASS EXPERIMENT / ACTIVE EXERCISE

Define “liquidity trap”. Next, go online and research “Japan’s Lost Decade” and the liquidity trap they suffered. Name two actions taken by either the government or the Bank of Japan to alleviate the problem. Why did they not work?

SOLUTIONS AND INSTRUCTOR NOTES

Discussion Question

Discuss how the Federal Reserve conducts expansionary monetary policy. What are some other names used to identify expansionary monetary policy?

Expansionary monetary policy is when the Federal Reserve, through open market operations, buys government bonds from banks thus putting more money into the economy. The money supply increases causing interest rates to fall. Lower interest rates leads to more borrowing thus creating an increase in demand. In addition, American bonds are now less attractive to foreign investors. This leads to a decline in the U.S. dollar. American products are now cheaper relative to foreign products which increases exports and decreases imports.

Other names for expansionary monetary policy include easy money, quantitative easing, and accommodative monetary policy.

Peer Group Problem Solving

Classical theory supports the quantity theory of money which is defined by the Equation of Exchange. What is it and how does it work?

The Equation of Exchange is determined by: M (money supply) x V (velocity) = P (price) x Q (quantity/output). In the long run, classicalists believe Velocity to be fixed. This means the amount of money you spend each month is consistent. Quantity/output is fixed at full employment thus changes in the Money Supply will cause a change in Price.

Examples will vary.

In-Class Experiment / Active Exercise

Define “liquidity trap”. Next, go online and research “Japan’s Lost Decade” and the liquidity trap they suffered. Name two actions taken by either the government or the Bank of Japan to alleviate the problem. Why did they not work?

A liquidity trap is when low interest rates fail to spur investment and demand. Answers will vary, however, in Japan money was wasted on trying to restore failing businesses as well as poorly planned public works projects.

For more in-class experiment and active learning ideas, visit www.econedactive.com