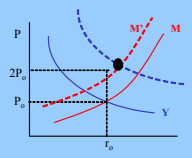
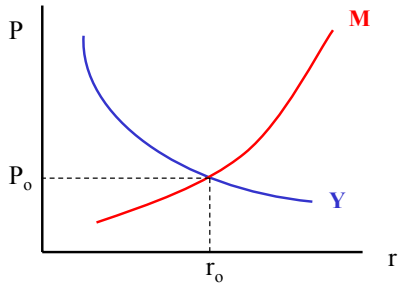
Qualifications to the Quantity Theory



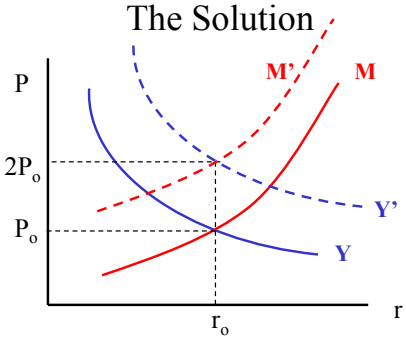
KENT STATE UNIVERSITY

Lectures in Macroeconomics- Charles W. Upton

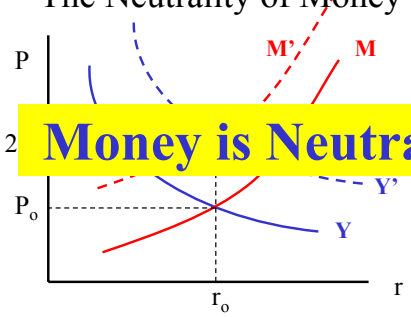
The Christmas Eve Caper



The Solution

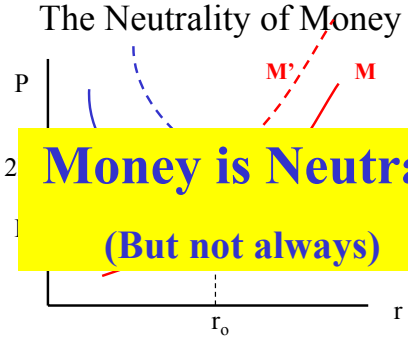


The Neutrality of Money



Money is Neutral

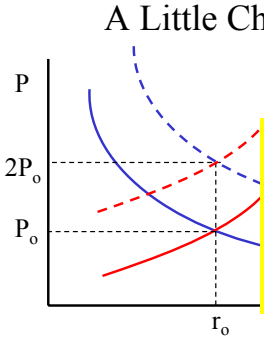
The Neutrality of Money



Money is Neutral

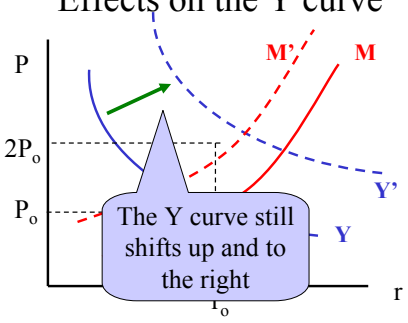
(But not always)

A Little Change

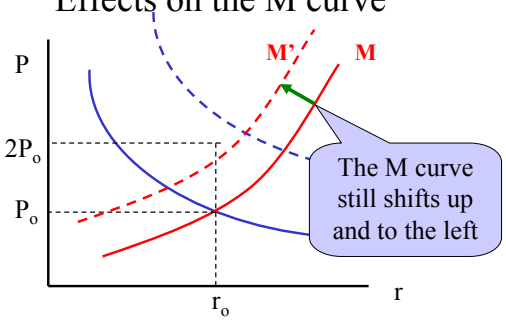


Suppose we modify our assumption, so that there are assets denominated in money terms.

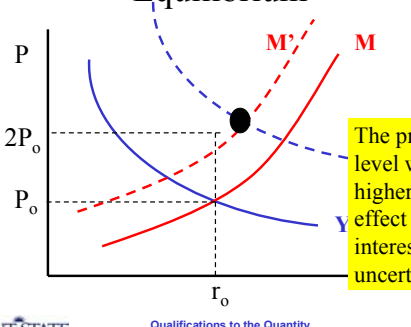
Effects on the Y curve



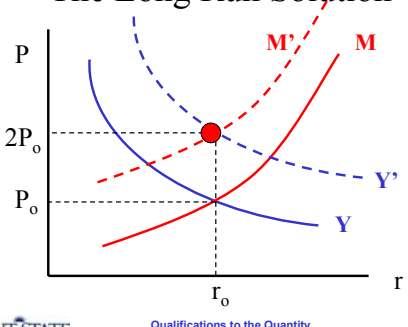
Effects on the M curve



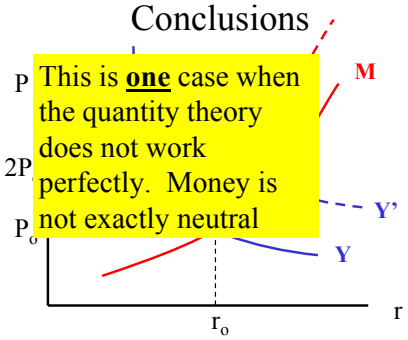
Equilibrium



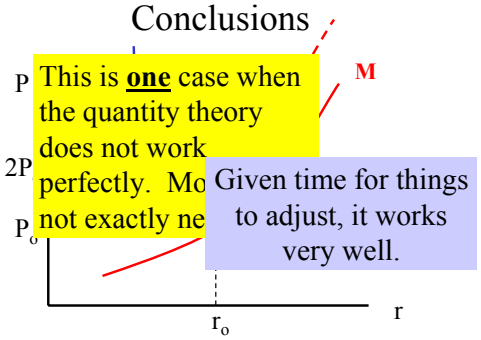
The Long Run Solution



Conclusions



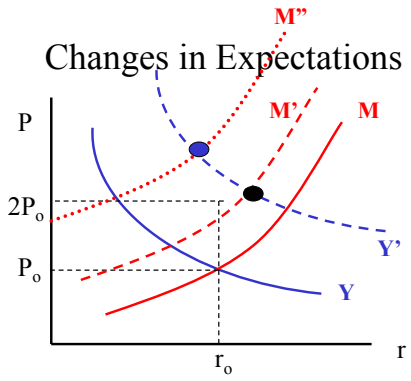
Conclusions



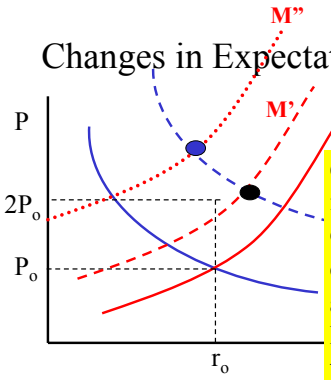
Another Exception

- The Christmas Eve Caper becomes permanent
- Distributions no longer in proportion to money holdings.
- There will come a day when people realize this is permanent.

Changes in Expectations

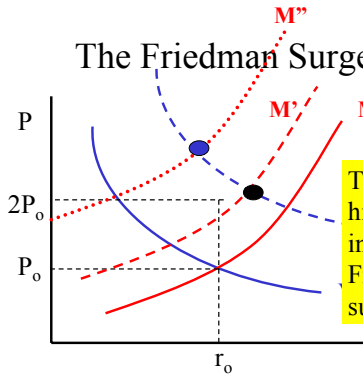


Changes in Expectations



Changed inflationary expectations changes η^e and hence r^n. M curve shifts to M"

The Friedman Surge



Thus even higher inflation, the Friedman surge.

The Friedman Surge

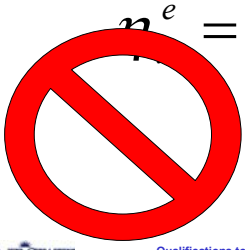
Milton Friedman

What determines inflationary expectations?

$$\eta_t^e = \eta_{t-1}$$

What determines inflationary expectations?

$$\eta^e = \eta_{t-1}$$



Rational Expectations

$$\eta_t = \eta_t^e + \varepsilon_t$$

Inflationary Expectations Include all Information

Rational Expectations

$$\eta_t = \eta_t^e + \varepsilon_t$$

Inflationary Expectations Include all Information

How to measure η^e

- US Treasury Rate

$$r^N \cong r^R + \eta^e$$

- Rate on Indexed Bonds

$$r^R$$

- Difference is η^e

End

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