1) Widespread availability of ATMs and new payment technologies have dramatically lowered the transactions costs associated with acquiring money.

a) Explain the impact of this drop in transaction costs on the labor market and the FE curve.

*This shock has no impact on labor markets and the FE curve*

b) Explain the impact of this drop in transaction costs on the capital market and the IS curve.

*This shock has no impact on the capital market or the IS curve*

c) Explain the impact of this drop in transaction costs on the money market and the LM curve.

*This shock will lower money demand. The drop in money demand lowers the interest rate in the money market – LM shifts down (right)*

d) Given your answers to (a) – (c), what will be the short term (Keynesian) effect of this shock. What will be the long term (Classical) effect?

*In the short term, the interest rate falls and production expands beyond capacity (intersection on IS and LM).*

*In the long term, prices rise, returning the economy to full production (LM returns to its initial location)*