Lemonade Loans

WITSOOTH · CLEVER TRUTH

AP MACROECONOMICS · UNIT 4

Name ____________ Period ______

DRIVING QUESTION

The government doesn't print money to fix the economy. So where does new money come from — and who controls the tap?

Answer before the game. Answer again at the end.

BEFORE THE GAME

> When you take out a loan, your bank doesn't go into a vault and hand you existing dollars. It creates new money by typing a number into your account. The Federal Reserve controls how much of that creation is allowed to happen — and that's the real lever that drives the entire economy.

Most people think the Fed "prints money." What do you think actually happens instead?

CONCEPTS — THREE IDEAS BEHIND THE CHAIN

CONCEPT 1

Liquidity

How easily an asset converts to cash. Reserves are perfectly liquid. Bonds are not. The Fed changes bank liquidity — which changes how much banks can lend.

CONCEPT 2

Money Supply (Ms)

The total money in circulation. Banks expand Ms by making loans — they create new money in the process. The Fed controls how much creation is allowed.

CONCEPT 3

Transmission Mechanism

The chain from Fed action to real-world outcome. Five steps separate the slider from the clinic's loan decision.

THE CHAIN — FILL IN THE BLANKS AS YOU PLAY

FED ACTION	→	BANK LIQUIDITY	→	MONEY SUPPLY	→	INTEREST RATE	→	REAL WORLD
Buy bonds / lower reserves	→	Assets become ______	→	Ms shifts ______ (right)	→	Equilibrium rate goes ______	→	Borrower gets the loan

Pitcher = money supply · Glass = money demand · Rate badge = equilibrium interest rate

DURING THE GAME — WATCH & RECORD

Liquidity — when you moved a slider, what changed about bank liquidity?

Money Supply — which lever moved Ms more: reserves or bonds?

The Chain — pick one scenario. Trace all five steps.

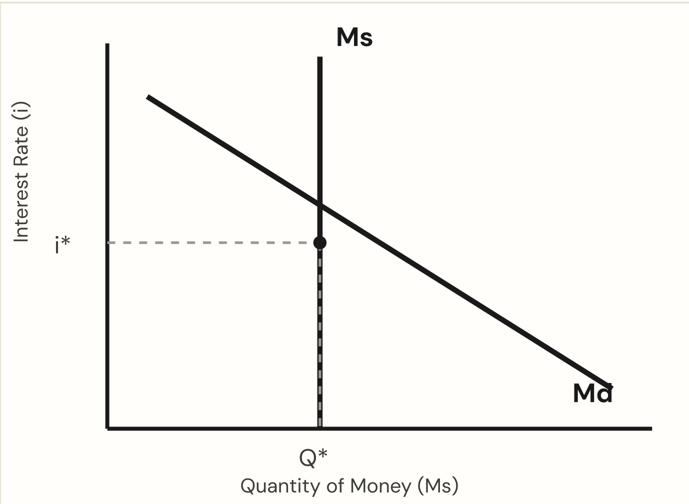
TRANSFER — 2022: THE FED TIGHTENS, AND YOUR RENT GOES UP

Inflation Hits 7.9% — the Fed Fights Back

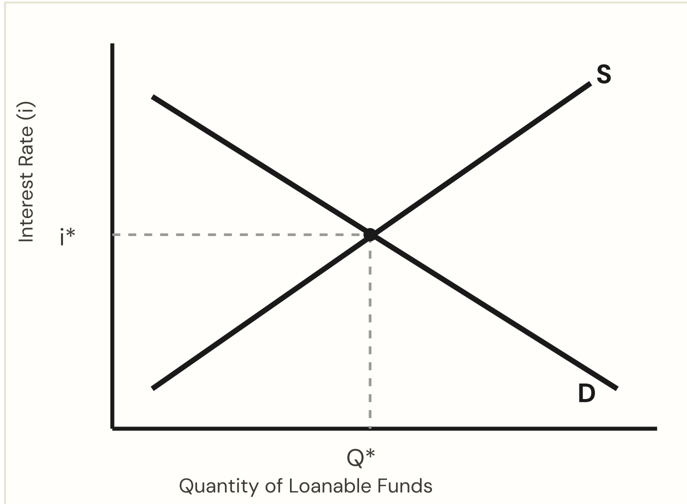
Inflation hit 7.9%. The Fed sold bonds and raised reserve requirements. Banks created less new money. Within a year, mortgage rates doubled from 3% to 6.7%. New home construction fell. Rent kept rising. The Fed never touched a single mortgage — it just changed how much new money banks were allowed to create.

Fed sells bonds → banks hold fewer liquid assets → less lending → Ms contracts. Money Market: shift Ms left, mark the new i*. Loanable Funds: shift S left, mark the new i* and Q*.

MONEY MARKET — DRAW THE SHIFT



LOANABLE FUNDS — DRAW THE SHIFT



A. On the Money Market, which curve shifted and why? Connect the bond sale to the change in Ms.

B. On Loanable Funds, what happened to the quantity of loans and the rate? Who felt it?

C. The Fed fought inflation — but renters got hurt. Accident, tradeoff, or failure? Use both graphs.

RETURN TO THE DRIVING QUESTION

The government doesn't print money to fix the economy. So where does new money come from — and who controls the tap?

Use Liquidity, Money Supply, and Transmission Mechanism in your answer.