**Notes for Quantity Theory of Money**

**Quantity Theory of Money:** M x V = P x Q

**Quantity Theory of Money:**

M= money

V= velocity (speed of circulation)

P= price

Q= quantity

Theory **assumes** that if the money supply increases, then inflation will increase **assuming** V and Q are held constant.

I.e. if money supply increases and velocity remains constant, then there must be an increase in either price or quantity to absorb the increase for this equation to remain true.

**Limitations:**

Assumes V and Q are unchanged but this is not always true

**E.g.** When prices rise rapidly people will be **reluctant** to hold money because it is losing its **purchasing power** so they will change it for goods and services as quickly as possible, so V changes.