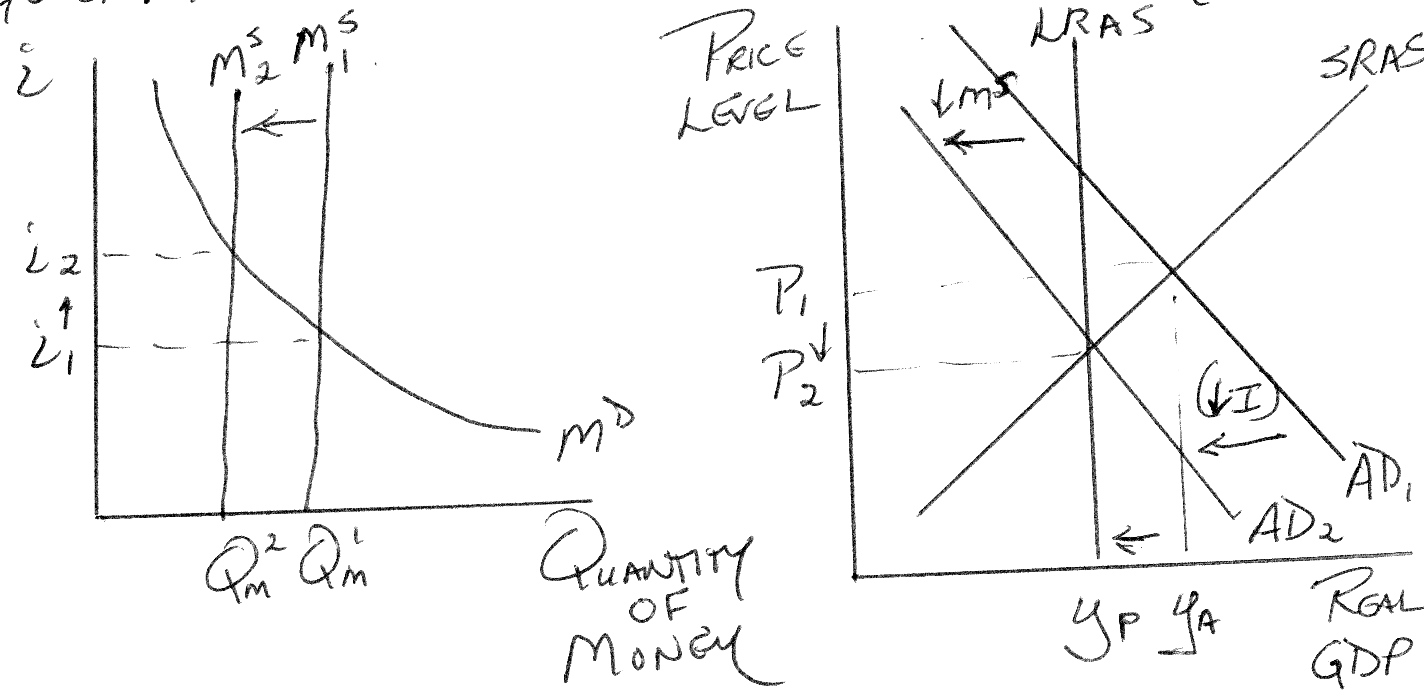
#5. SUPPOSE THE CENTRAL BANK OF NEW ZEALAND BELIEVES INFLATION IS TOO HIGH, SO THEY WILL PERFORM AN OPEN MARKET SALE. SELLING A GOVERNMENT BOND DECREASES THE MONEY SUPPLY.



THE MONEY SUPPLY DECREASE INCREASES INTEREST RATES, WHICH THROUGH THE TRANSMISSION MECHANISM INTO INVESTMENT WILL DECREASE INVESTMENT AND SHIFT AD LEFT.

OM SALE ⇒ ↓M^s ⇒ ↑i ⇒ ↓I ⇒ AD left.

PRICE LEVEL FALLS

REAL GDP FALLS (BACK TO POTENTIAL REAL GDP)

UNEMPLOYMENT RISES (BACK TO THE NATURAL RATE)