Household's Utility Function

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Utility function:

- c · consumption of services
- m/p real money balances
  - m nominal money balance
  - p price level
  - → real wealth
  - → wealth in the utility function

Justification for (real) wealth in the utility

- **Introspection** people enjoy accumulating wealth, in particular b/c wealth offer/ social status / power

- **Neuroscientific** evidence that wealth itself provides utility, independent of consumption it can buy [Camerer, Loewenstein, Prelec, 2005]

Household's utility function

$$u\left(c, \frac{m}{p}\right) = \frac{X}{1+X} \cdot c^{\frac{\varepsilon-1}{\varepsilon}} + \frac{1}{1+X}\left(\frac{m}{p}\right)^{\frac{\varepsilon-1}{\varepsilon}}$$

$X > 0$ taste for services relative to wealth
high X ⇒ services are more valued

$\varepsilon > 1$ · elasticity of substitution b/w consumption
& real money balances