The modern quantity theory, developed by Milton Friedman, treats money like any other asset and concludes that economic agents want to hold a certain quantity of real money balances based on factors like permanent income, expected returns on other assets relative to money, and expected inflation (Wright & Quadrini, 2009). More formally, according to Friedman, the demand for real money balances (Md/P) is directly related to permanent income (Yp) and indirectly related to the expected differential returns from bonds, stocks, and goods vis-à-vis money (rb − rm, rs − rm, πe − rm).

In contrast, John Maynard Keynes's liquidity preference theory examines why economic agents hold money, identifying three reasons: transactions, precautions, and speculations. The transactions and precautions motives mean that real money balances increase directly with income. The speculative motive creates an inverse relationship between real money balances and interest rates - when rates are high, the opportunity cost of holding money is higher and people expect rates to fall, so they hold less money; when rates are low, people expect them to rise so they hold more money.

Friedman's modern quantity theory proved superior because it was more complex, specifying three types of assets rather than just bonds. It did not assume the return on money was zero or constant. Velocity was pro-cyclical, not constant. And Friedman predicted interest rate changes would have little effect on money demand because returns on different assets would move together. This held until the 1970s when money demand became more sensitive to rates, causing velocity to fluctuate unpredictably.

In summary, while Keynes provided important insights, Friedman built on his work with a more sophisticated understanding of money demand and velocity. But instability after the 1970s undermined aspects of Friedman's theory, showing that ongoing advances in monetary theory were still needed.

References:

Wright, R.E. & Quadrini, V. (2009). Money and Banking. Saylor Foundation.

https://www.saylor.org/site/textbooks/Money%20and%20Banking.pdf