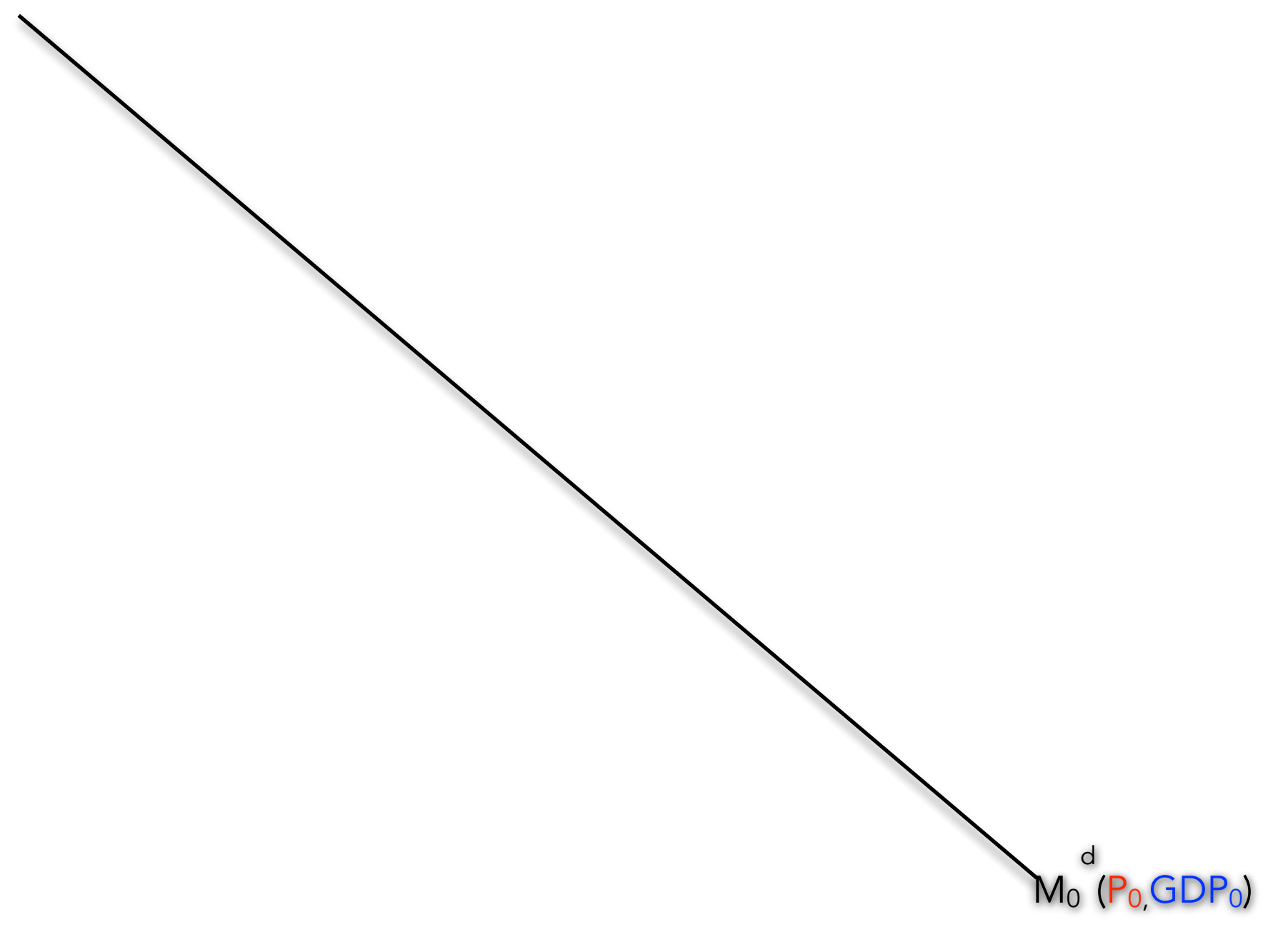




i





$$i_0 = 5\%$$

$$M^d = 300b$$

$$i_1 = 3\%$$



$$M^d = 900b$$

$$i_2 = 1\%$$



$$M^d = 1,200b$$

T





















a











a

S













P



















Assume the Money Market



starts at equilibrium

M_0^s



$M_0^s = 900b$





P







e











e

a

S

e











6















e

p

u

b







W









e

e





a



g

e









u





b

2



a



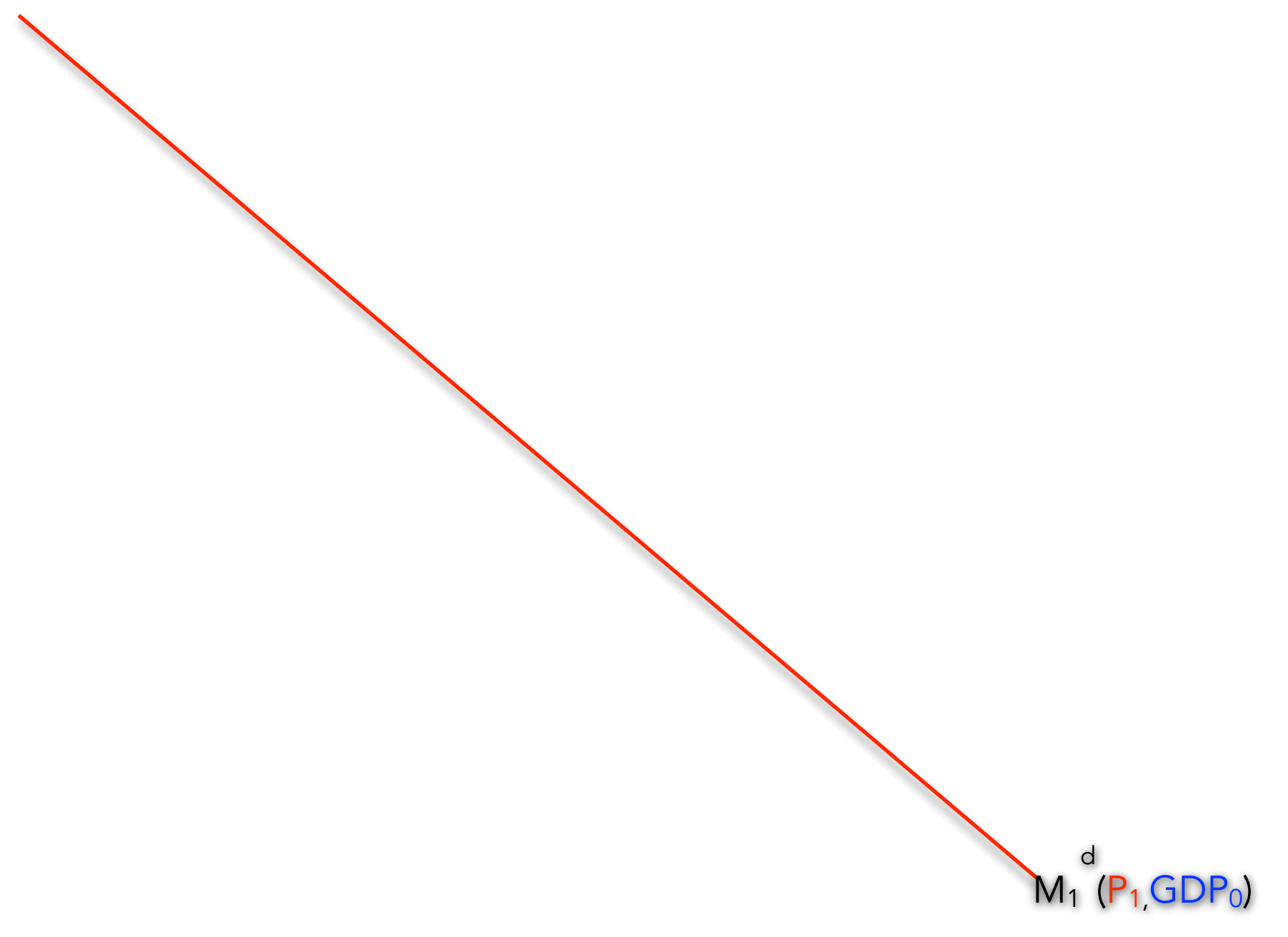


e

S



A rightward shift in the Demand for
Money



Short of liquid
balances



When there are shortages of liquid
balances, money is scarce and
there is pressure for the interest
rate to rise

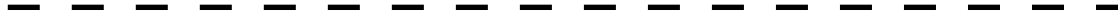


The interest rate will rise to



a new equilibrium at 5%

$$\dot{i}_0 = 5\%$$





New
equilibrium

The effect of an increase in the Price Level

If **prices increase** (inflation) the public will need **larger** liquid balances

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