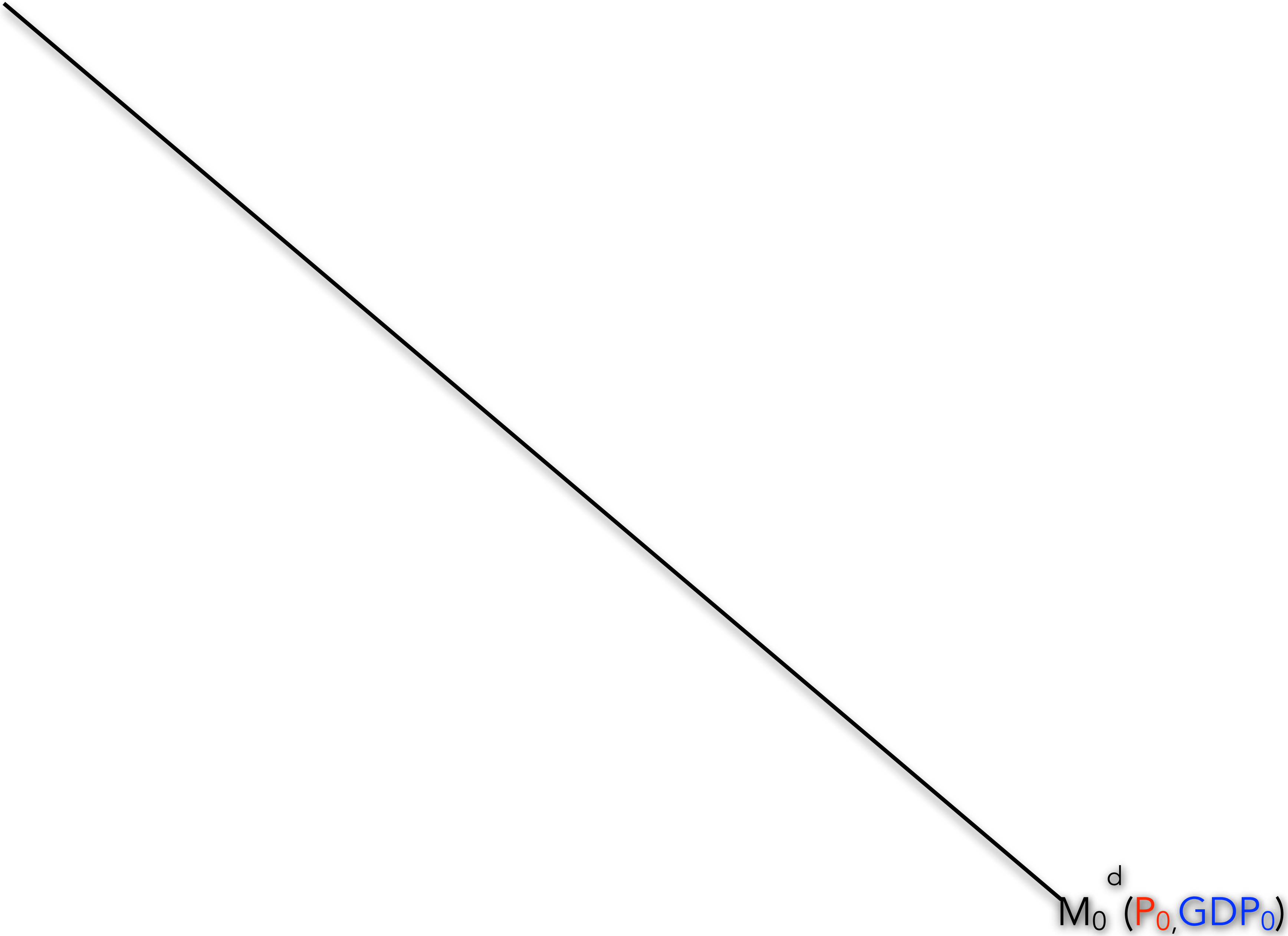
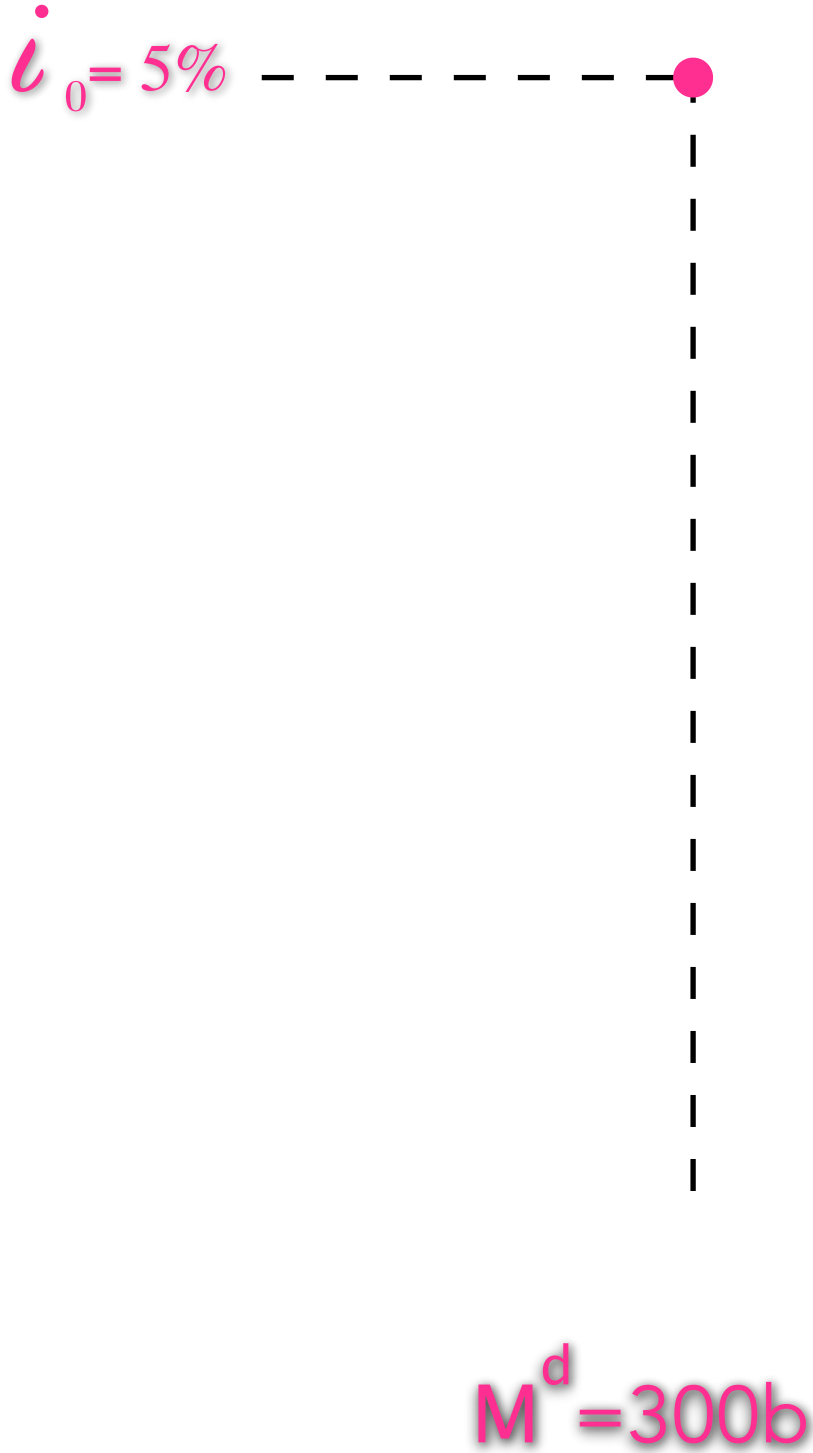
$i_1 = 1\%$

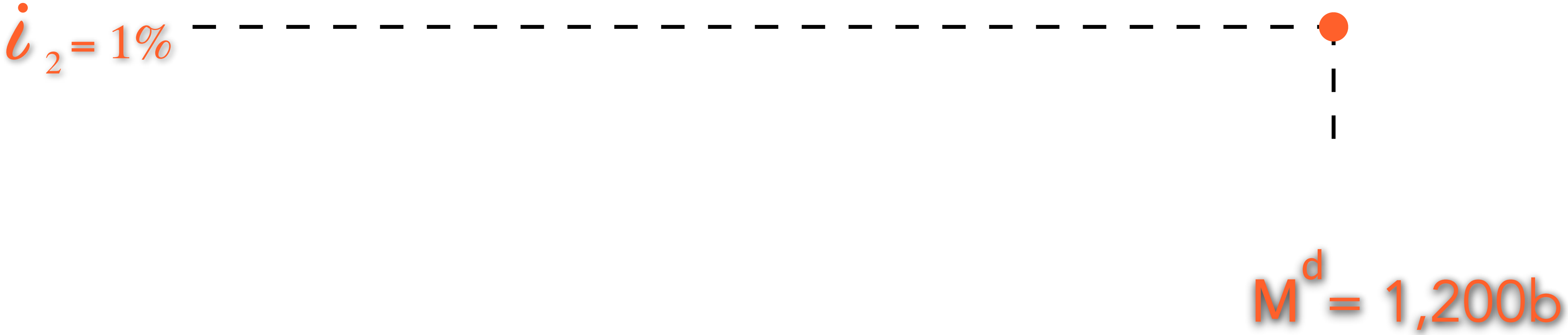
Currency+
Deposits

i


M_0^d (P_0,GDP_0)


$i_0 = 5\%$
$M^d = 300b$


$i_1 = 3\%$
$M^d = 900b$


$i_2 = 1\%$
$M^d = 1{,}200b$

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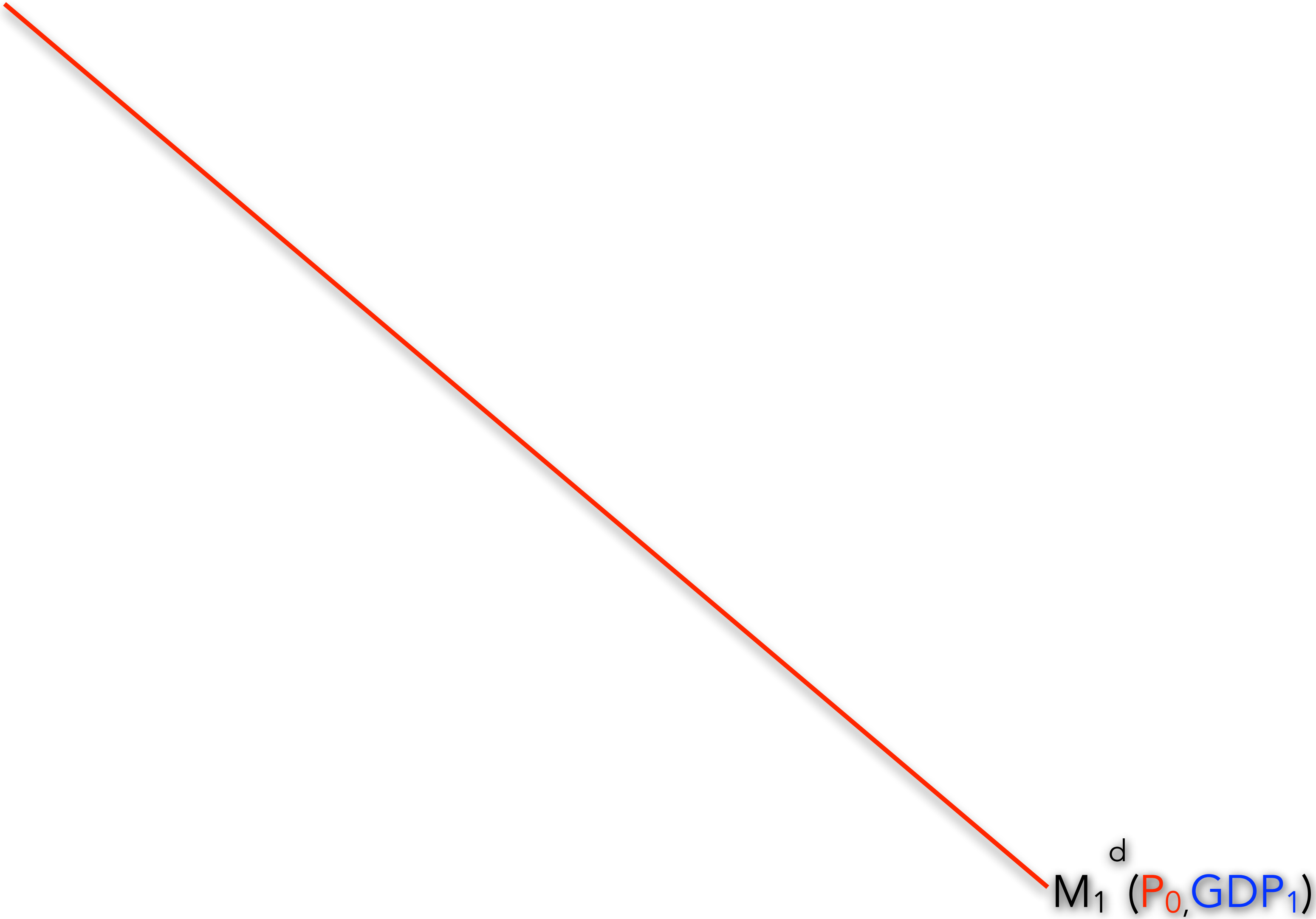
Assume the Money Market starts at equilibrium

M_0^s

$M_0^s = 900b$


$M_1^d\ (P_0, GDP_1)$

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A leftward shift in the Demand for Money excess liquid balances

The interest rate will fall to a new equilibrium at 1%

When there are excess liquid balances, money is plentiful and there is pressure for the interest rate to fall


New equilibrium

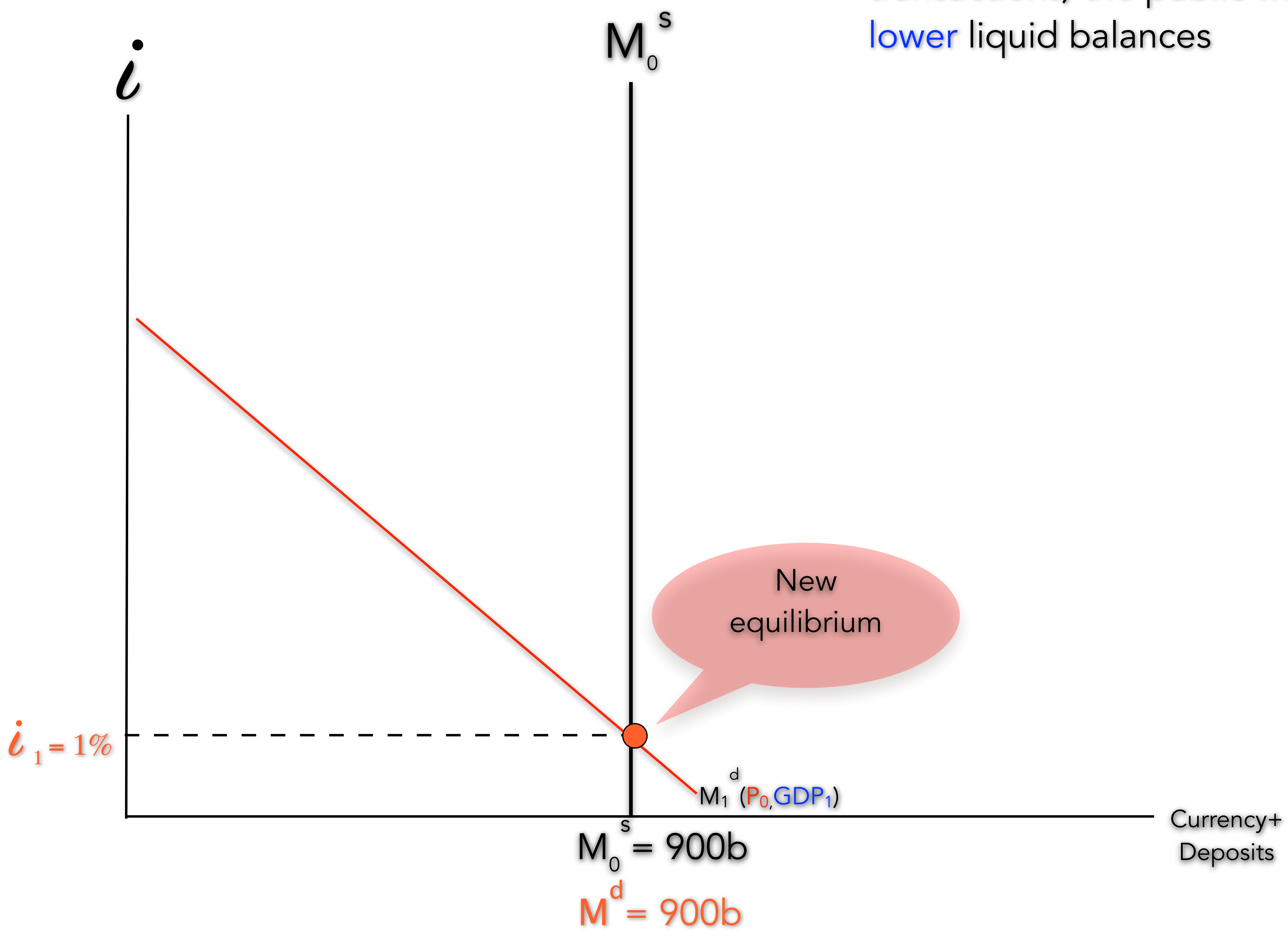
$$M^d = 900b$$

The effect of a decrease in GDP

If GDP decrease (fewer transactions) the public will need lower liquid balances

The effect of a decrease in GDP

If GDP decrease (fewer transactions) the public will need lower liquid balances



The interest rate will fall to a new equilibrium at 1%