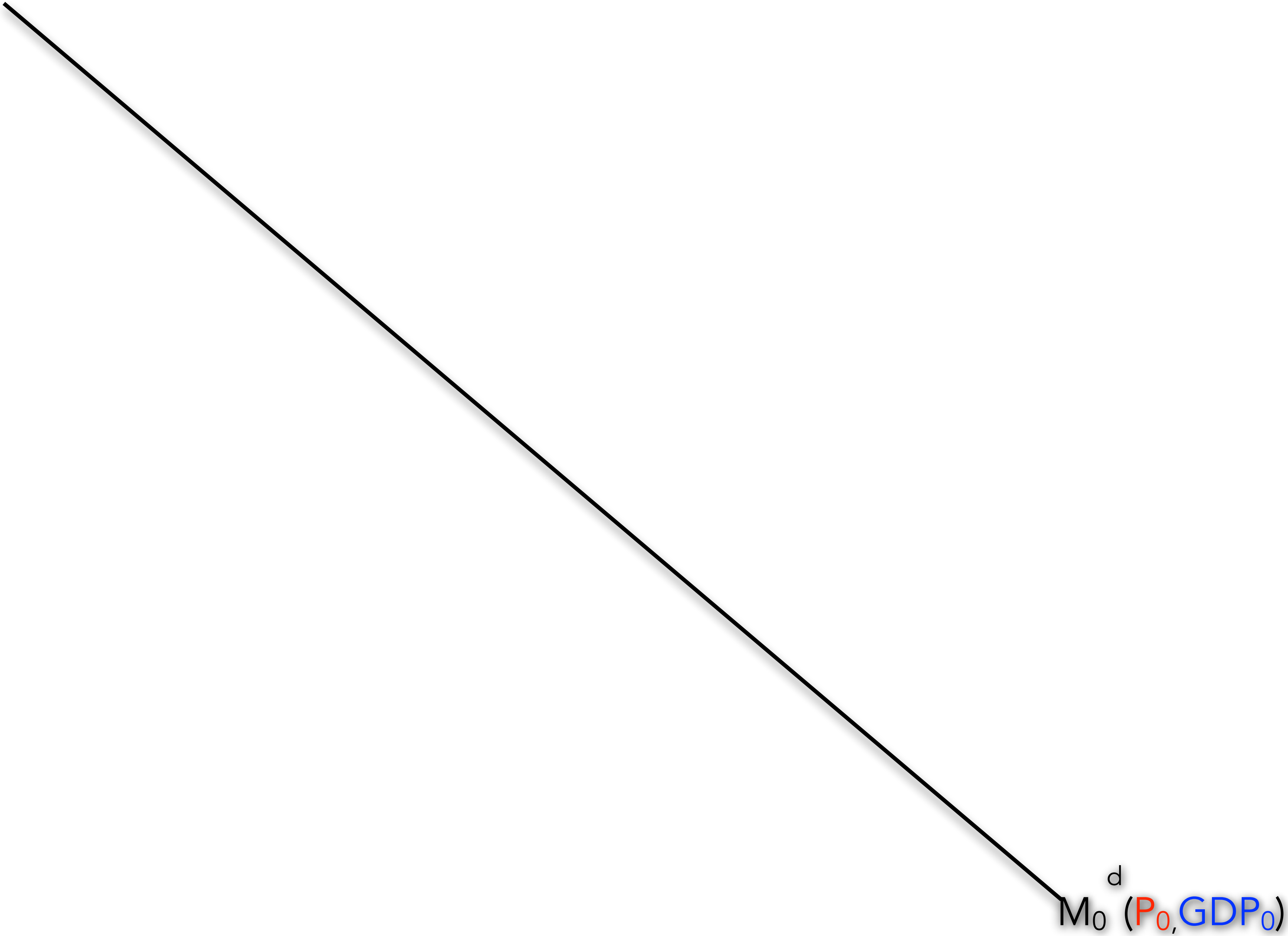
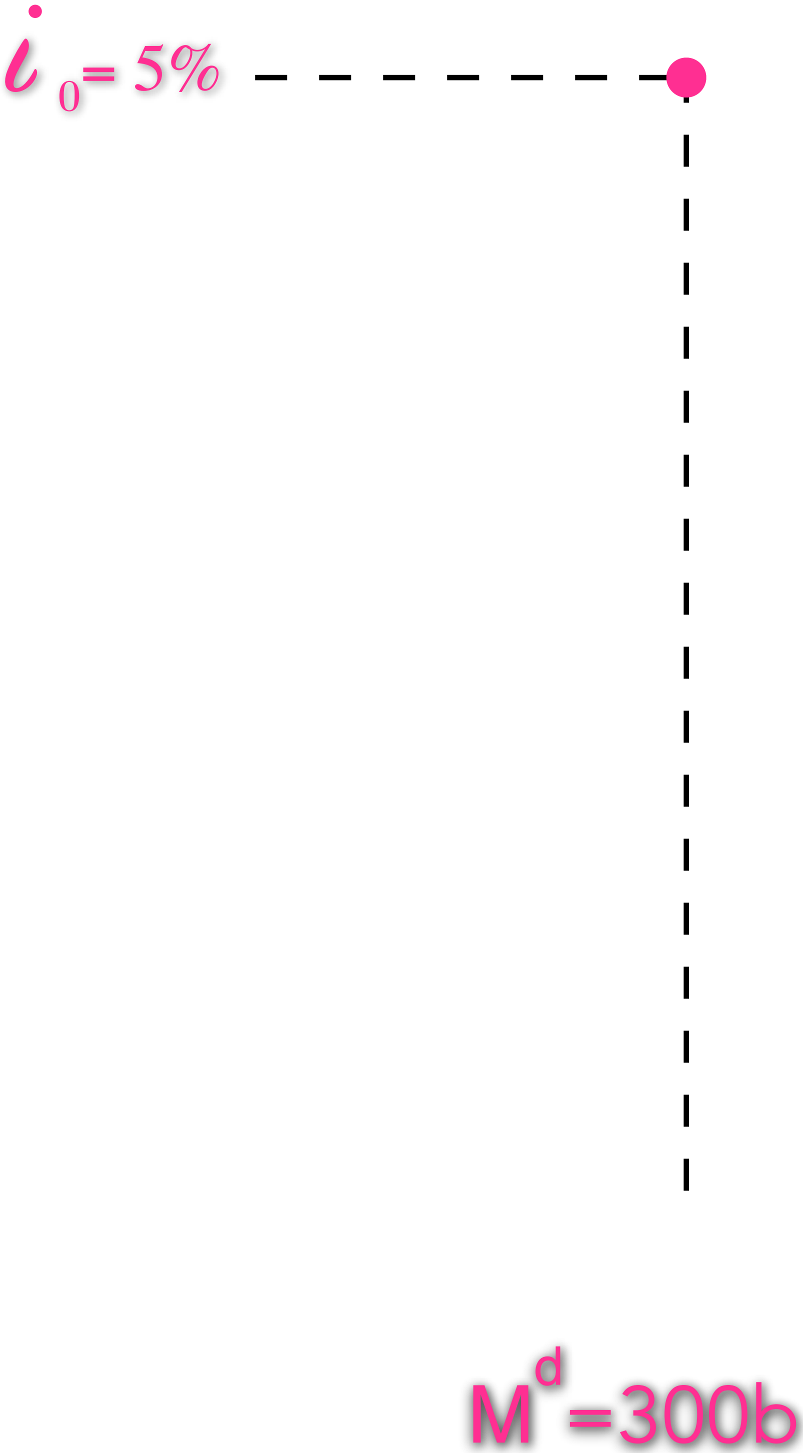
$$i_1 = 1\%$$

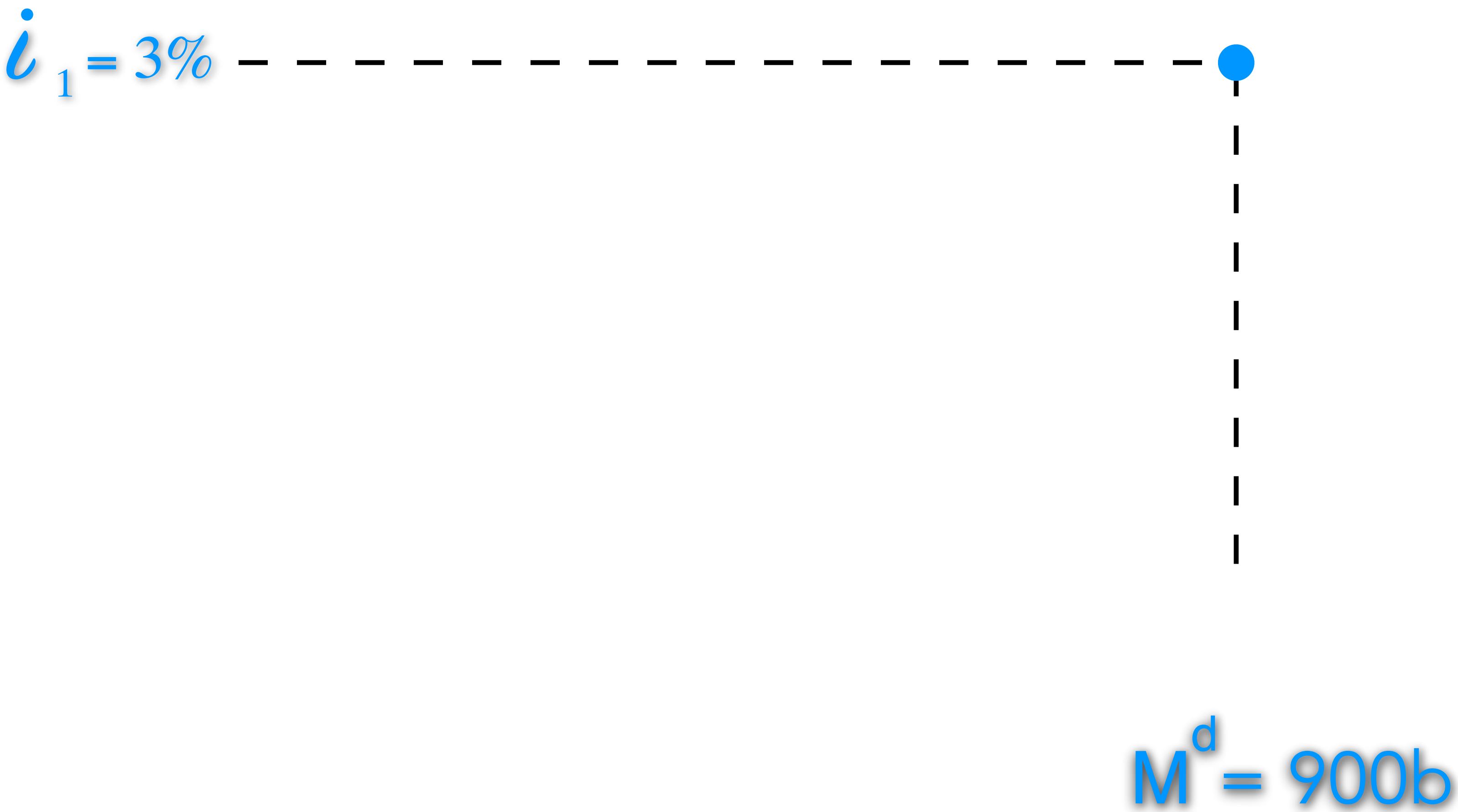
Currency+
Deposits

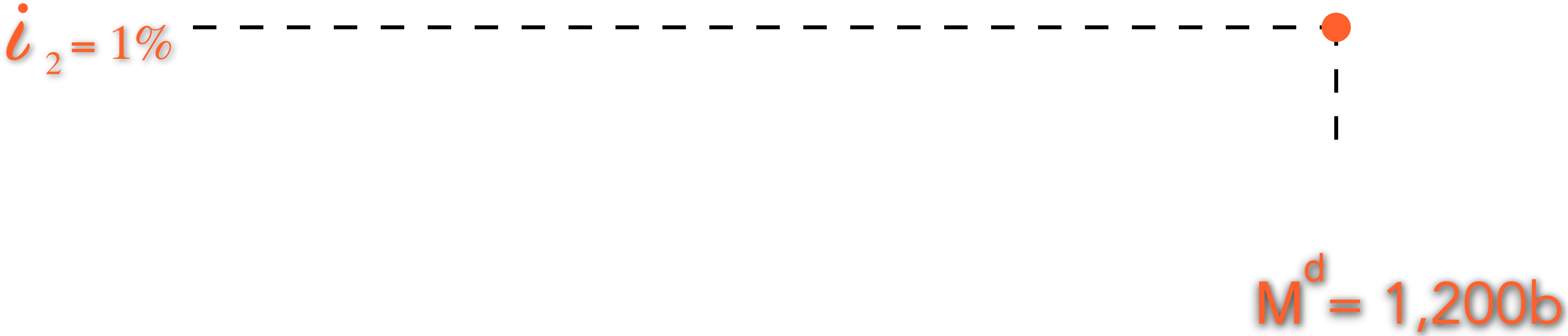
i


$M_0^d\ (P_0, GDP_0)$



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


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


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

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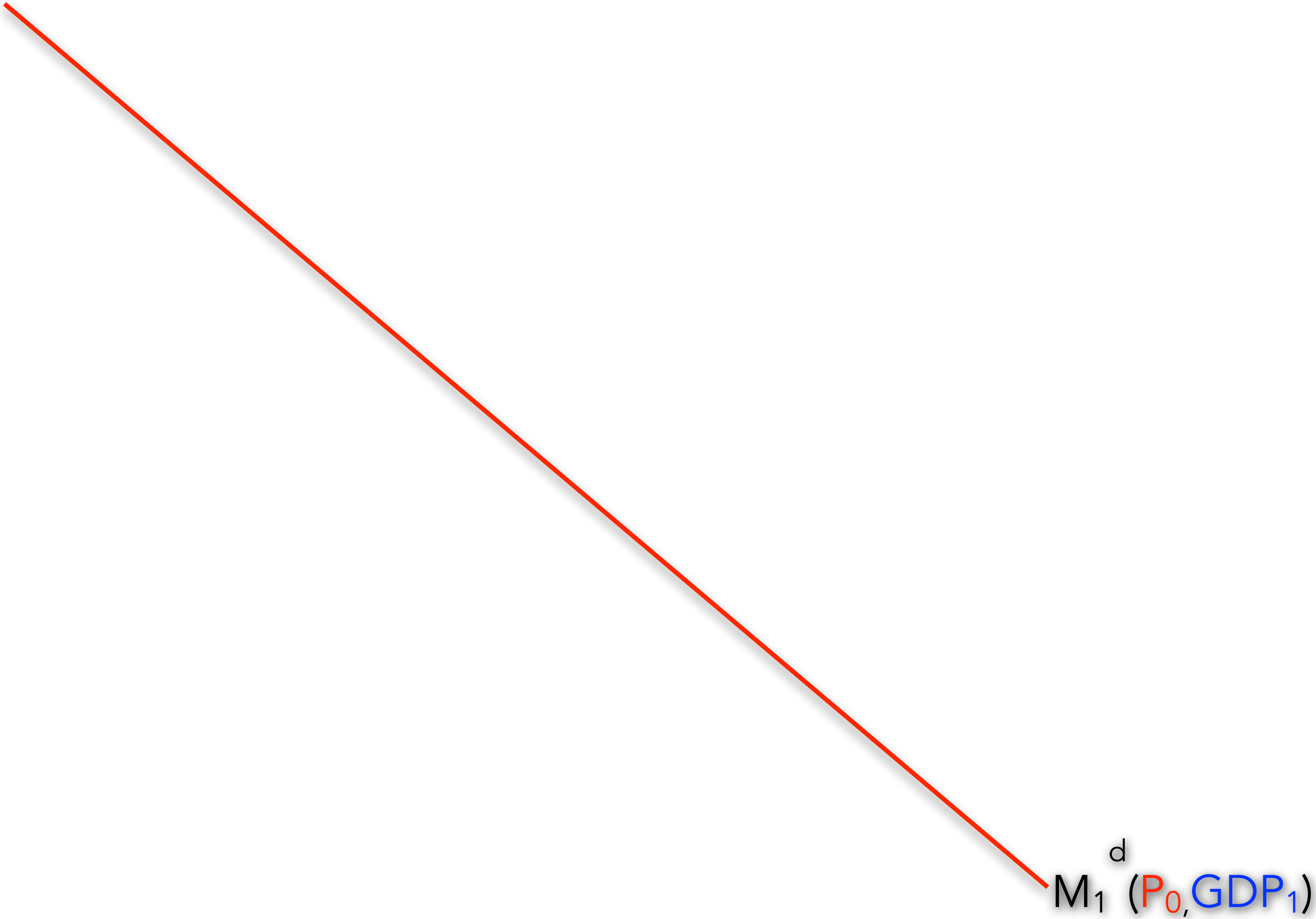
Assume the Money Market starts at equilibrium

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 at 3%

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

$$M^d = 900b$$

I leave the effect of a Increase in GDP to you to work as an exercise

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

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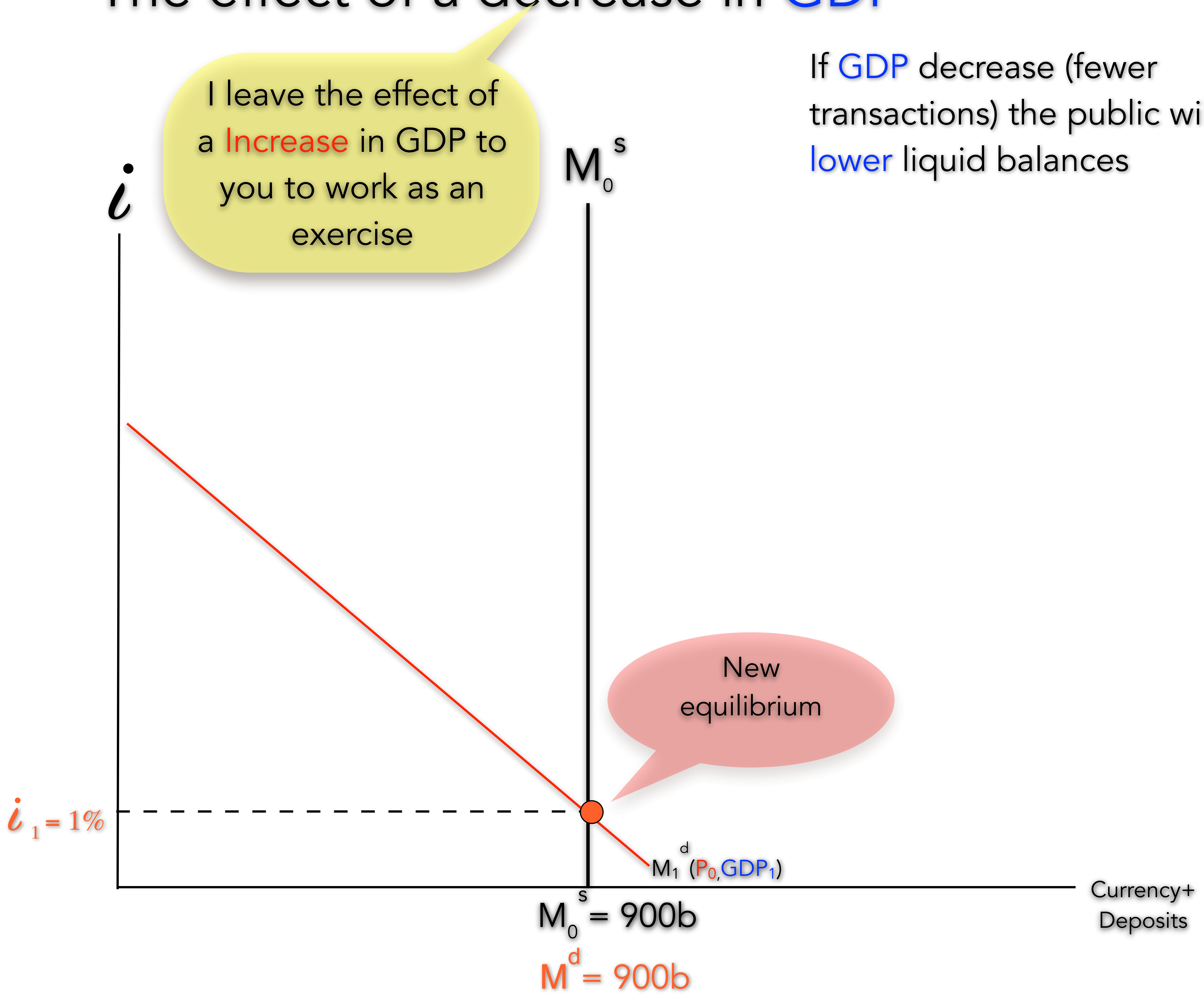

The interest rate will fall to a new equilibrium at 1%