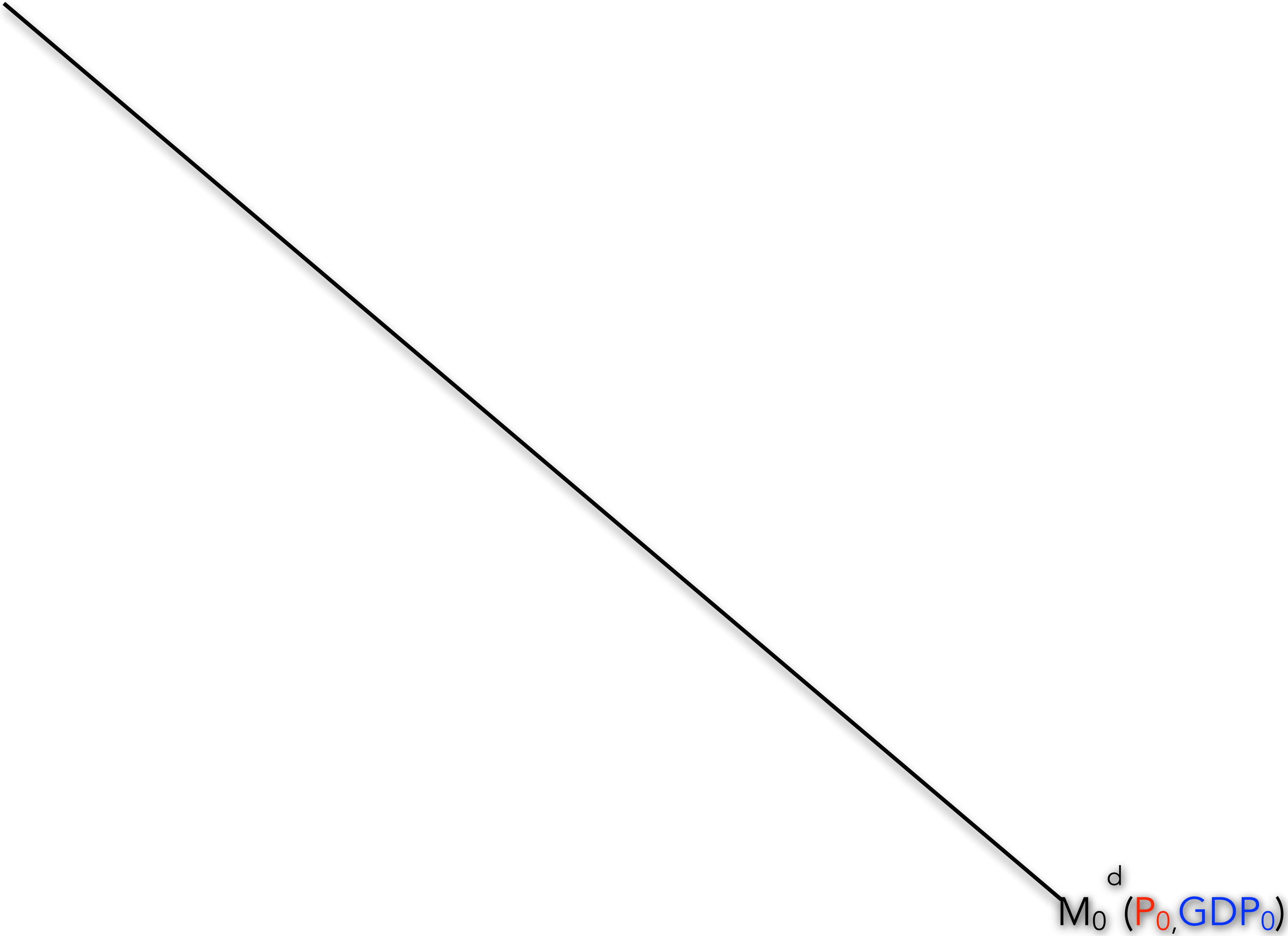
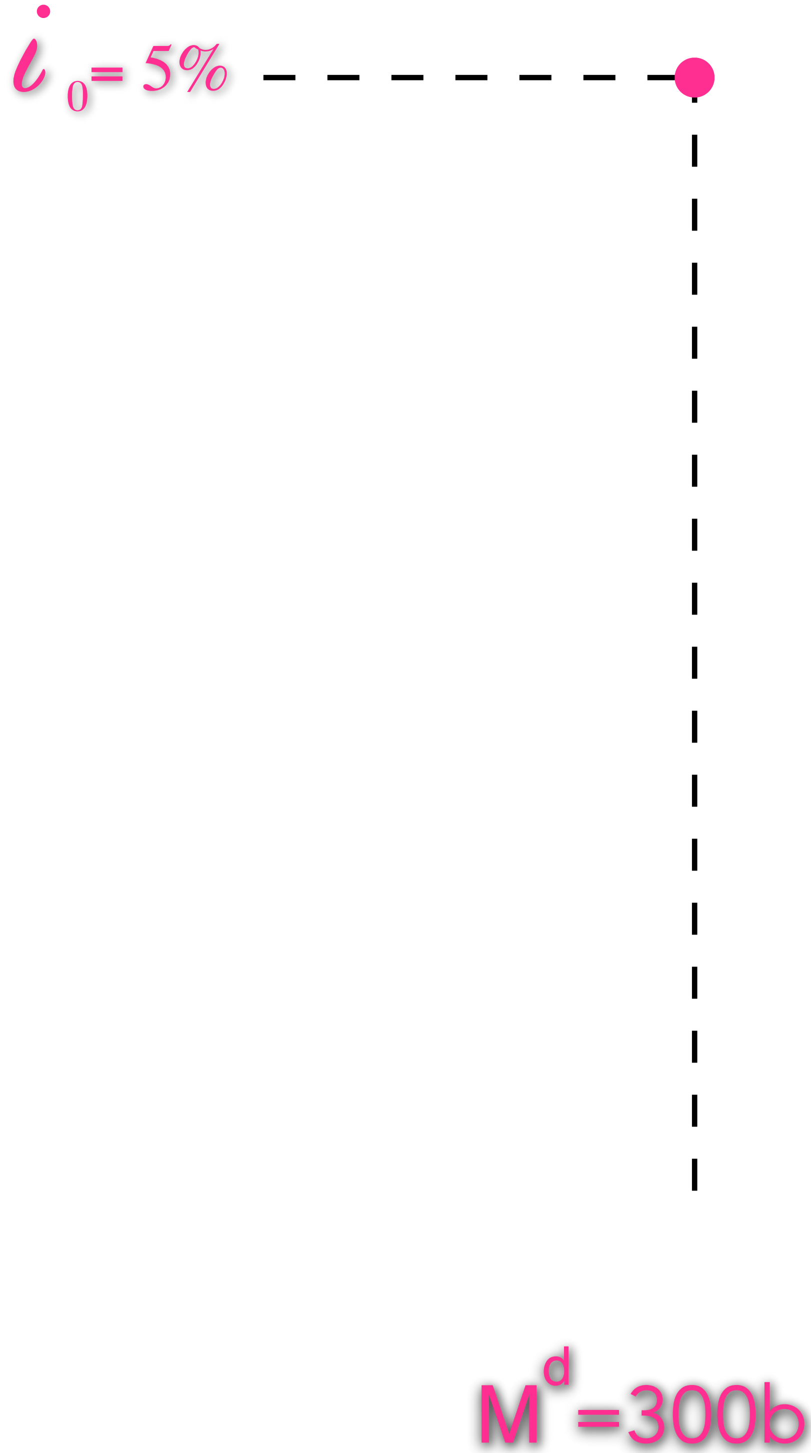
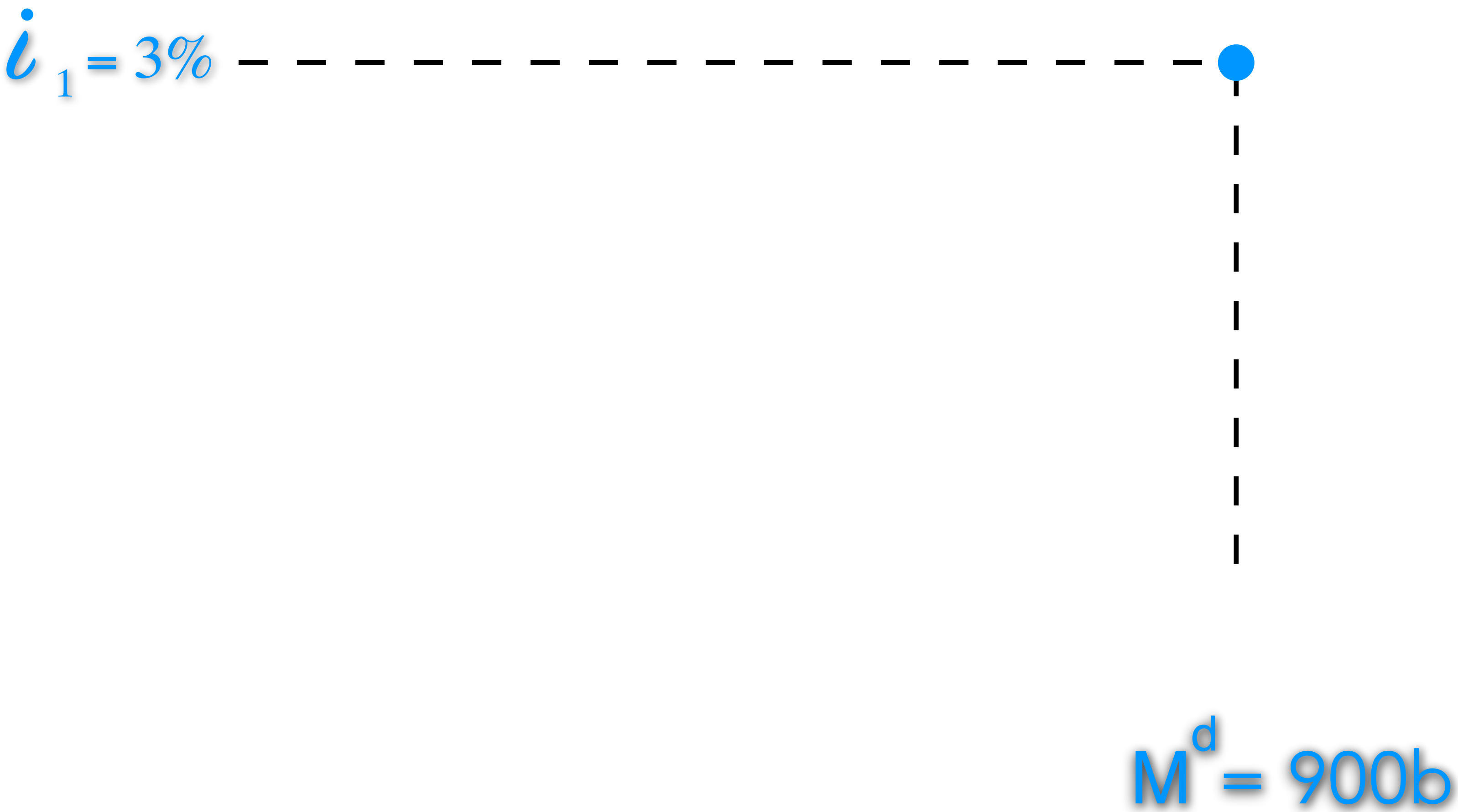
Currency+
Deposits

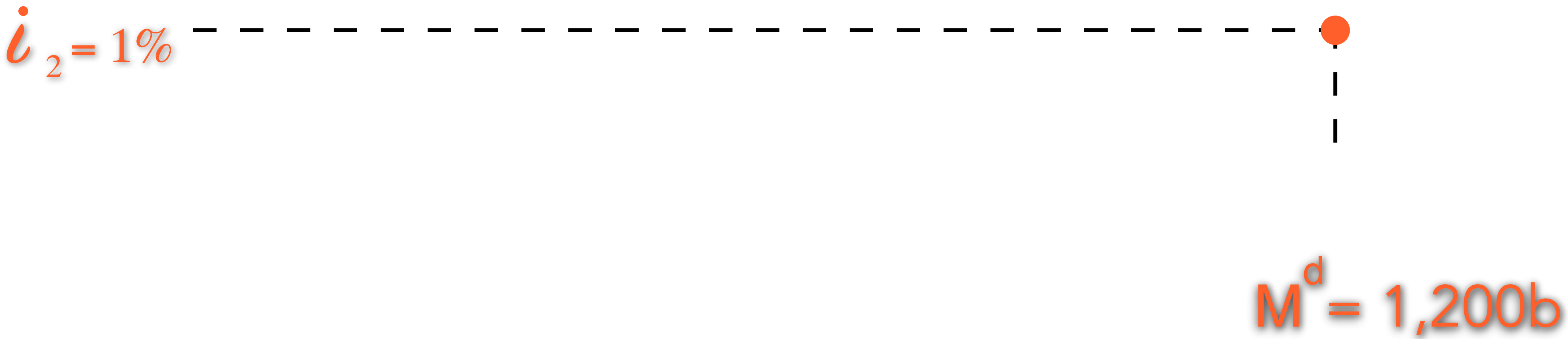
i


$M_0^d (P_0, GDP_0)$


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



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


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

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Assume the Money Market starts at equilibrium at 3%

$$M_0^s$$

$$M_0^s = 900b$$

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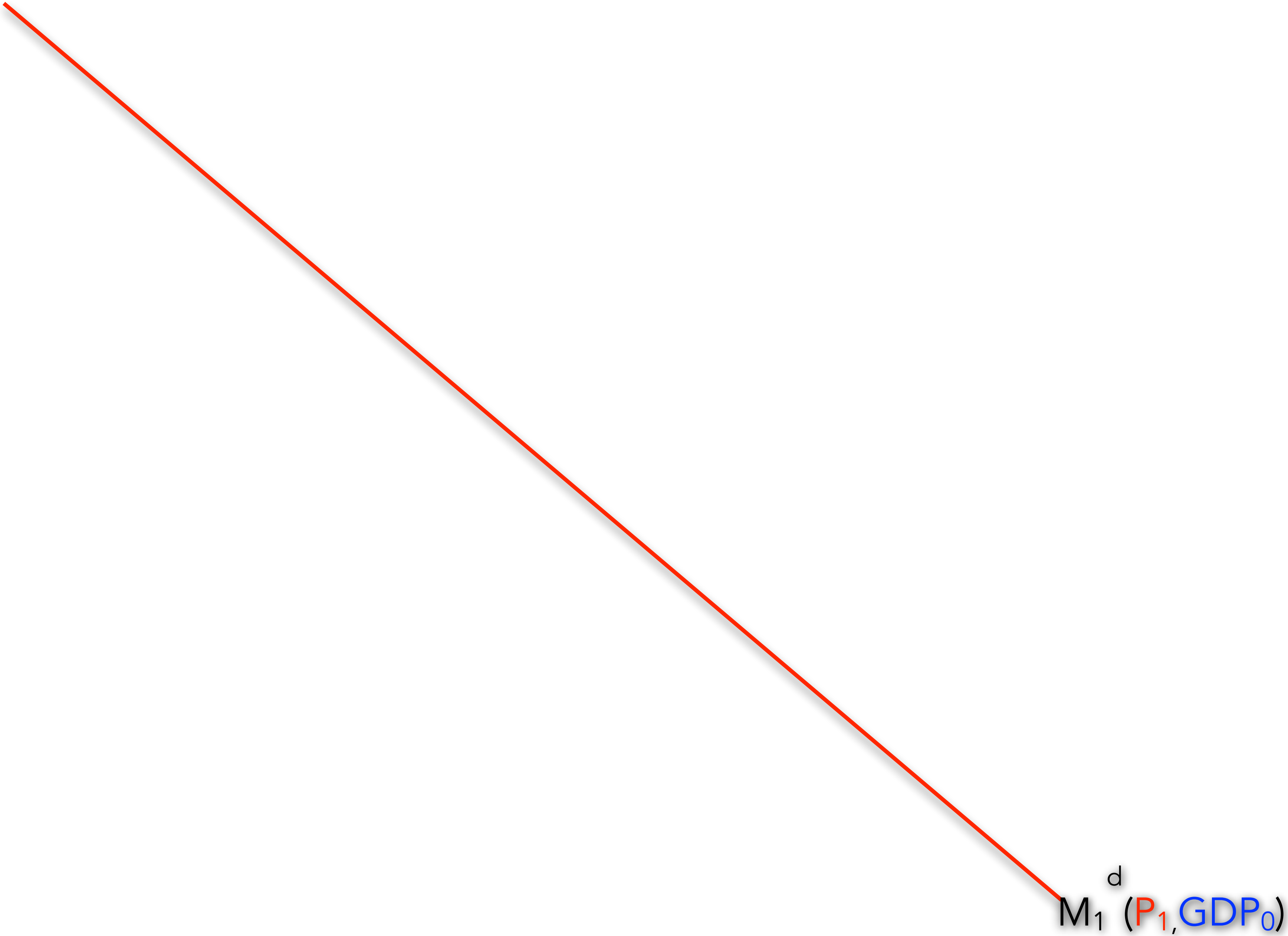
A rightward shift in the Demand for Money


$M_1^d (P_1, GDP_0)$

Short of liquid balances at 3%

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%

$i_0 = 5\%$


New
equilibrium

I leave the effect of a Decrease in the Price level for you to work as an exercise

The effect of an increase in the Price Level

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

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