



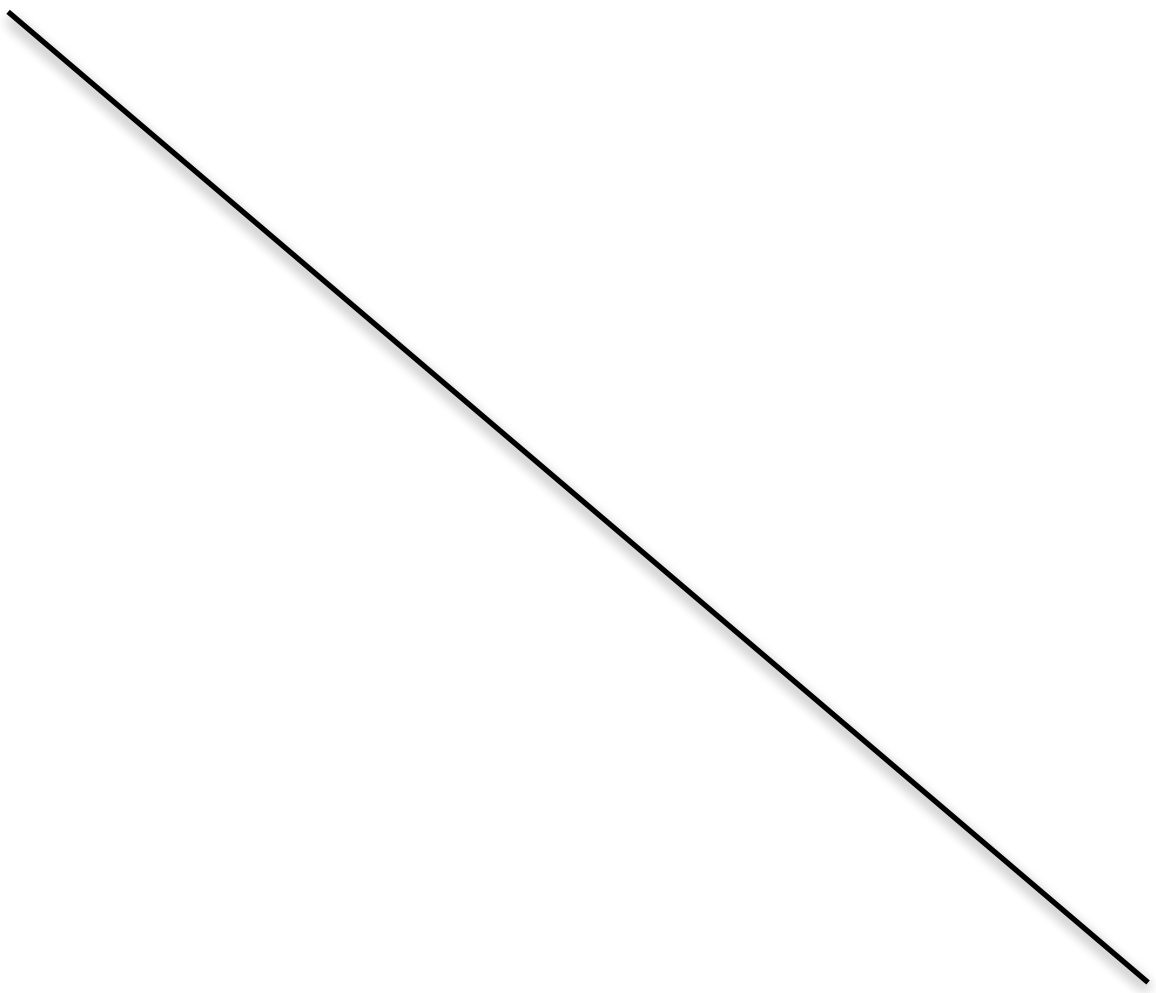
Currency

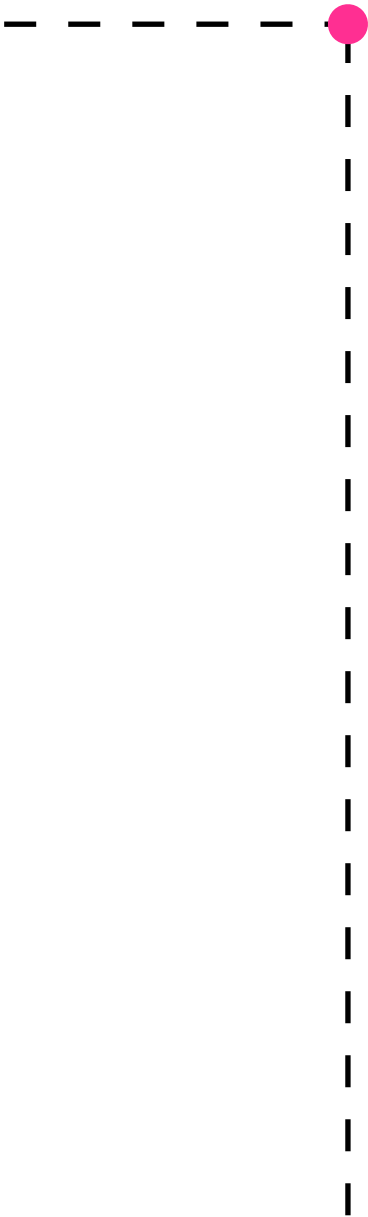
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+ Deposits

*i*







$$M^d = 500$$



For each interest rate, the demand for money  $M^d$  represents the need for liquid balances for a given price level (**P**) and a given **GDP**









G



P











e

a

S

e





h



e

**P**

U

**b**







**b**



u

**Y**

S

m











W



W













e





a



g

e











U





**b**

a





a







S







**p**

a

Y













a



S

a













S

$i_0$

$i_1$



For all interest rates, the demand  
for liquid balances will be **higher**



A rightward shift in the Demand for  
Money

$$M^d(P_0, GDP_0)$$



$M^d(P_0, GDP_1)$







P













d







e

a

S

e





d







a















h



**p**

U



**b**







W















d





W

e











U



d

**b**



a



a







S

a



S



V





**Y**











g



S









a

**P**



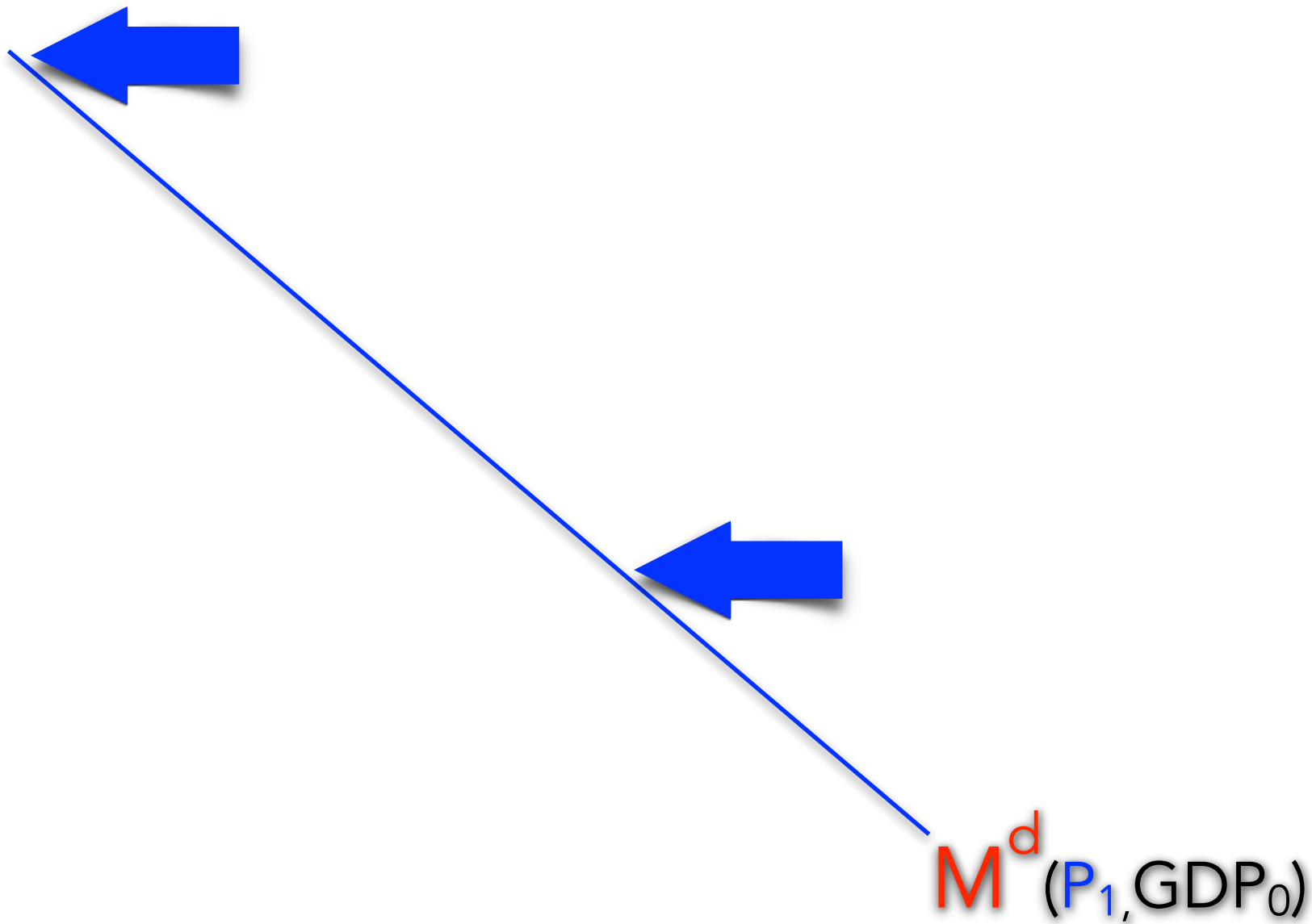




For all interest rates, the demand  
for liquid balances will be **lower**



A leftward shift in the Demand for  
Money



How much money is needed for  
transactions?



If lunch is cheaper:  
price is \$5/lunch,  
then I need to have  
 $7 \times 5 = \$35$  in cash or  
check

If I buy lunch **and**  
**dinner** 7 days a  
week, then I need  
 $14 \times 15 = \$210$  in  
cash or check

If GDP increase (the public buys more)  
we will need larger liquid balances to  
pay for more transactions

If Prices decrease (deflation) the public will need lower liquid balances as everything is cheaper

# How much money is needed for transactions?

If **GDP increase** (the public buys more) we will need **larger** liquid balances to pay for more transactions

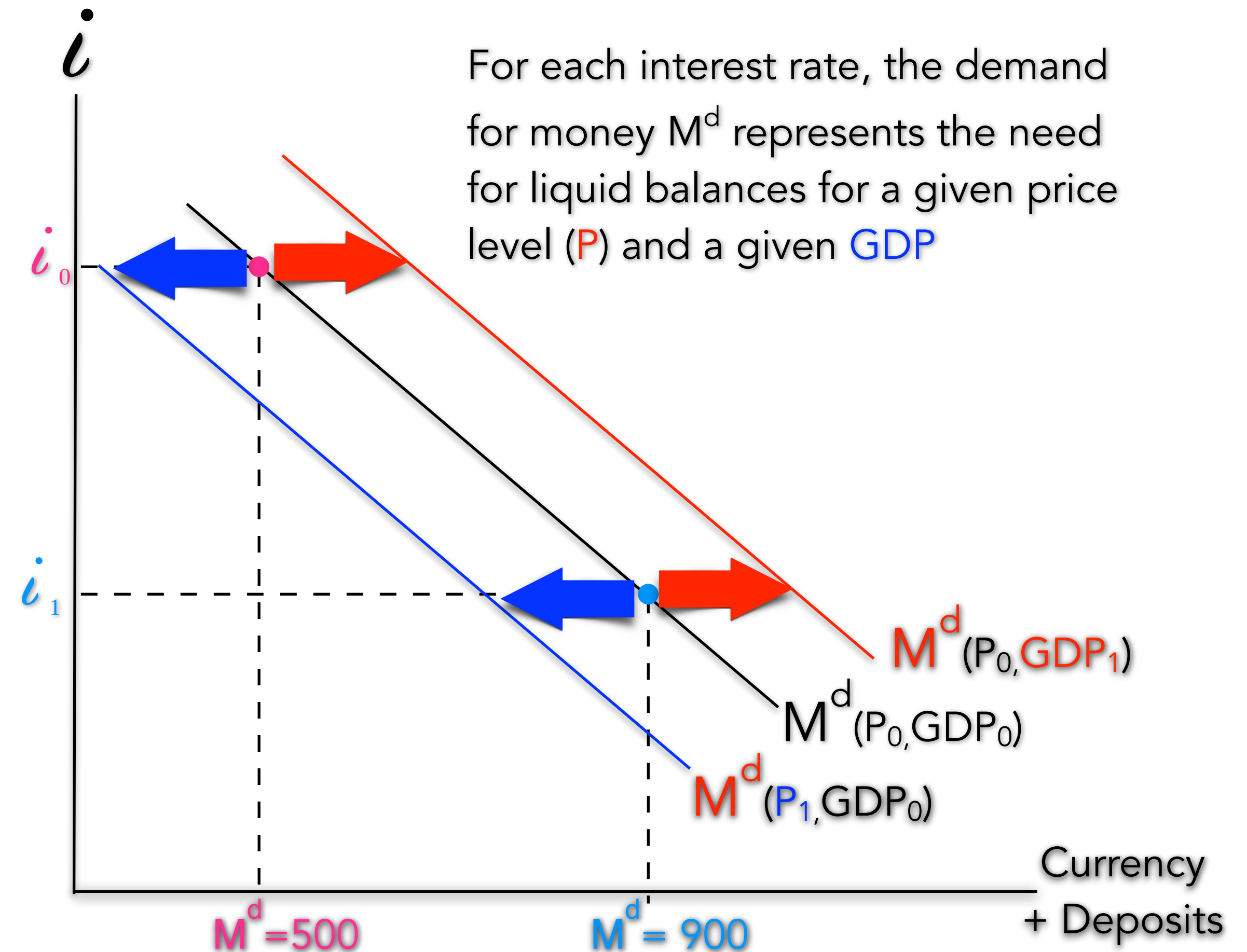
➡ For all interest rates, the demand for liquid balances will be **higher**

➡ A **rightward shift** in the Demand for Money

If **Prices decrease** (deflation) the public will need **lower** liquid balances as everything is cheaper

➡ For all interest rates, the demand for liquid balances will be **lower**

➡ A **leftward shift** in the Demand for Money



# Understanding the Supply and Demand for Money

