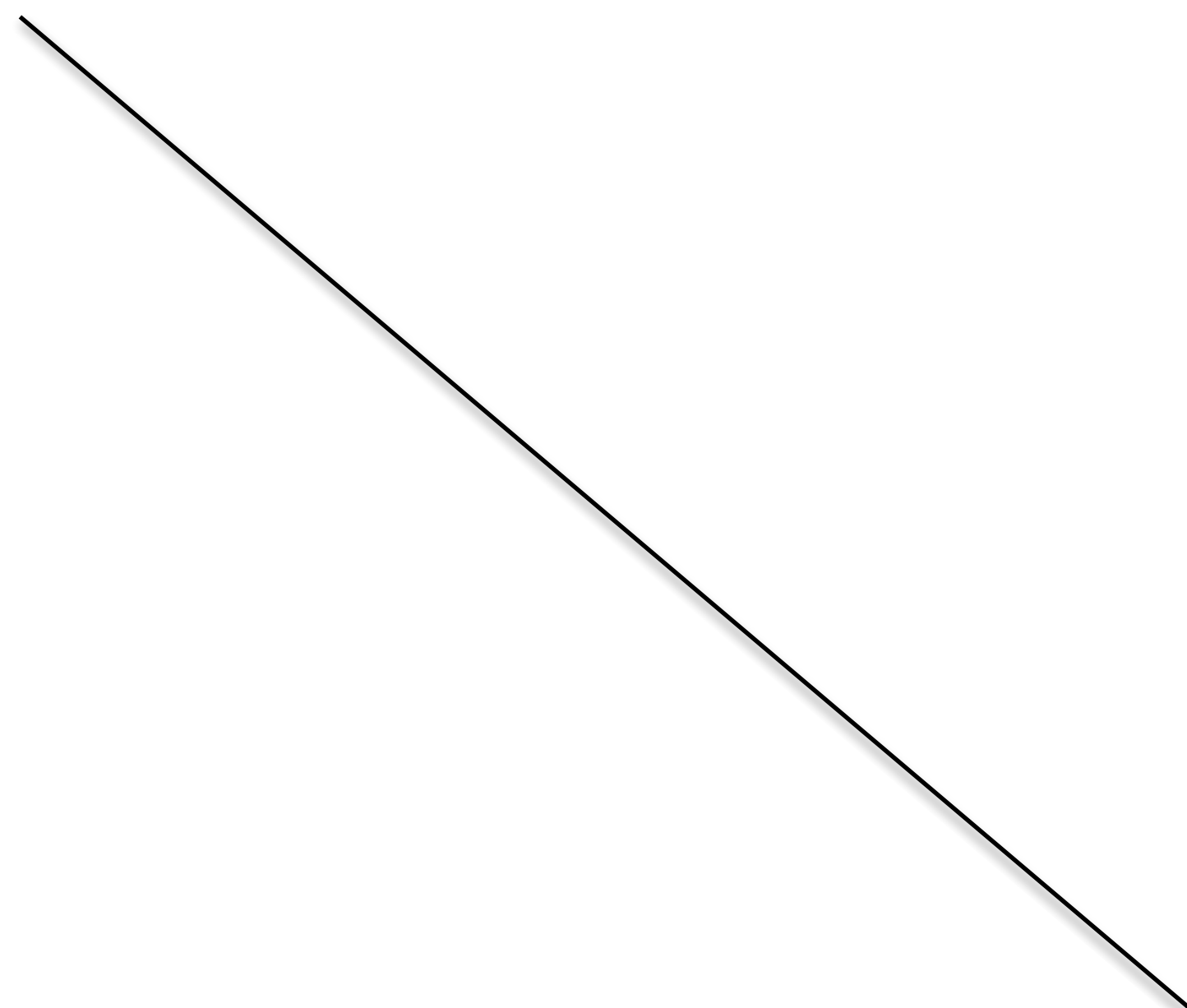


i





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

$i_0 = 6\%$

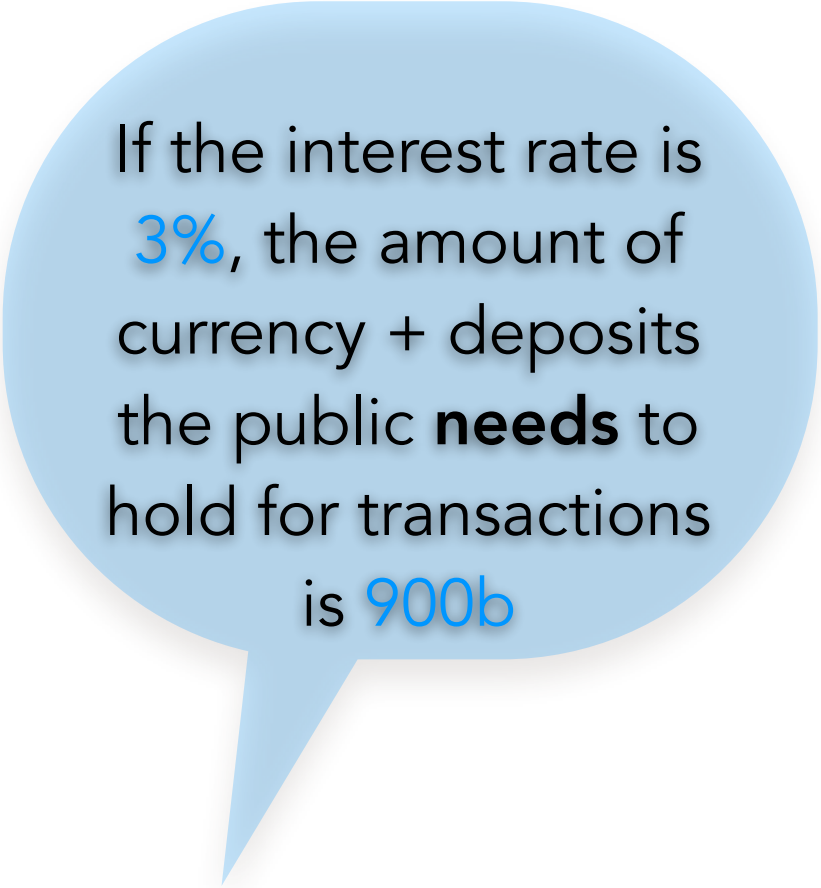


$M^d = 300b$

$$i_1 = 3\%$$

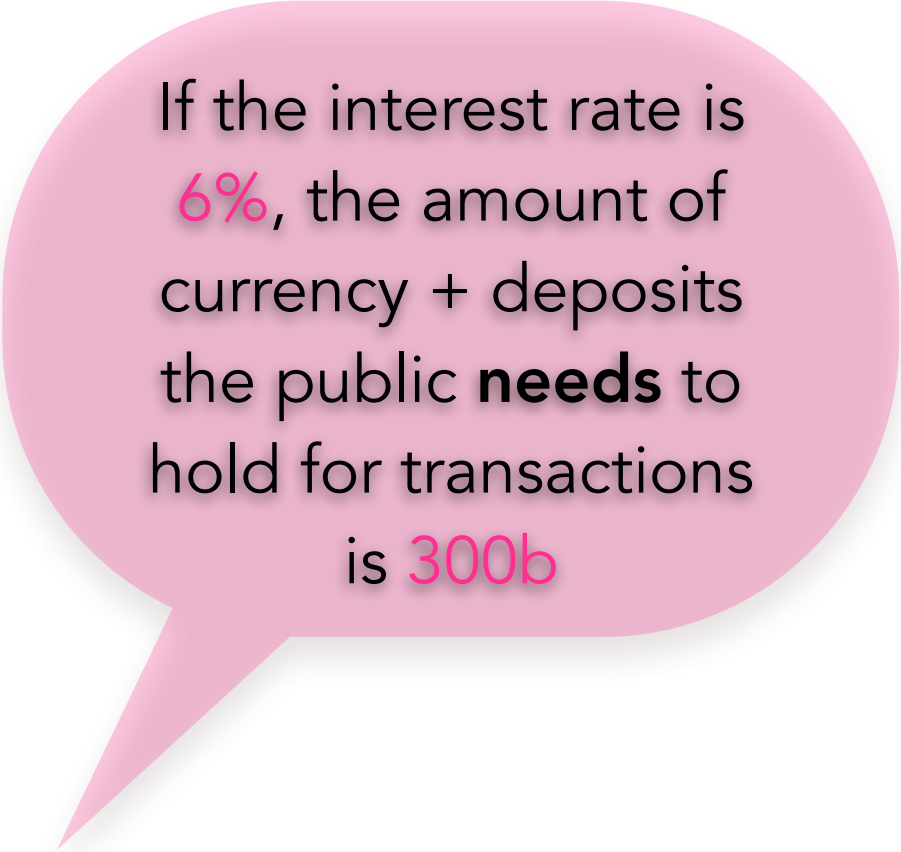
$$M^d = 900b$$

M^s is the amount of
currency + deposits
the public **actually**
holds = 900b



If the interest rate is
3%, the amount of
currency + deposits
the public **needs** to
hold for transactions
is 900b

An example



If the interest rate is
6%, the amount of
currency + deposits
the public **needs** to
hold for transactions
is 300b

$$i_2 = 1\%$$

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

If the interest rate is
1%, the amount of
currency + deposits the
public **needs** to hold
for transactions is
1,200b

i

M^s

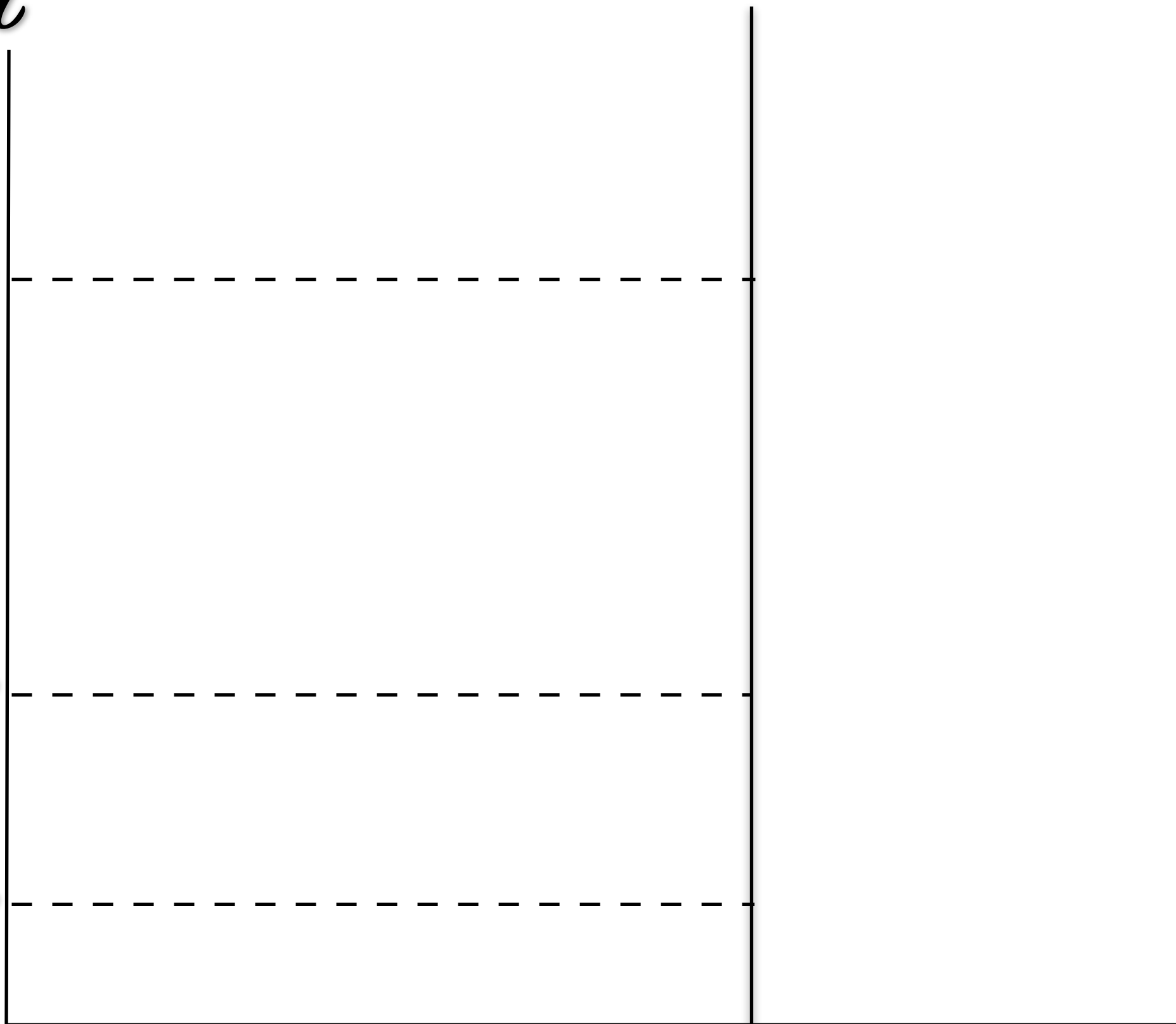
$i_0 = 6\%$

$i_1 = 3\%$

$i_2 = 1\%$

$M^s = 900b$

Currency +
Deposits



The Money Supply

The Money Demand

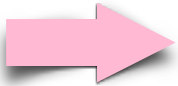


If the interest rate is 3% the public has exactly as much liquid
balances as they need for everyday transactions



If the interest rate is 6% the public is holding (in cash and deposits) more liquid balances than they need for everyday transactions

The public has **excess liquid balances** which they do not need for transactions, sitting idle (not earning interest) in cash and checking accounts



The public does **not**
have enough liquid
balances (cash and
deposits) to pay for
transactions



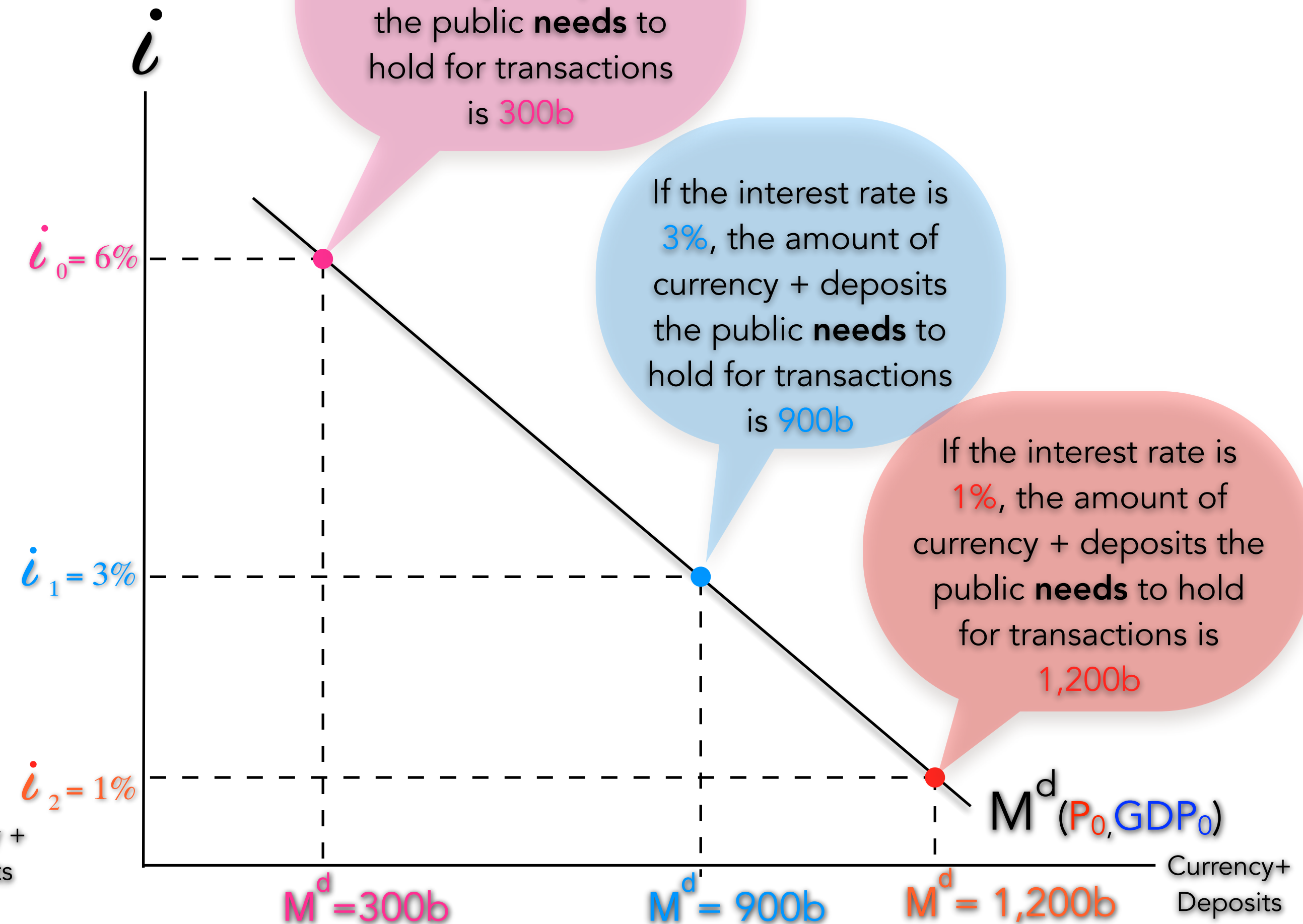
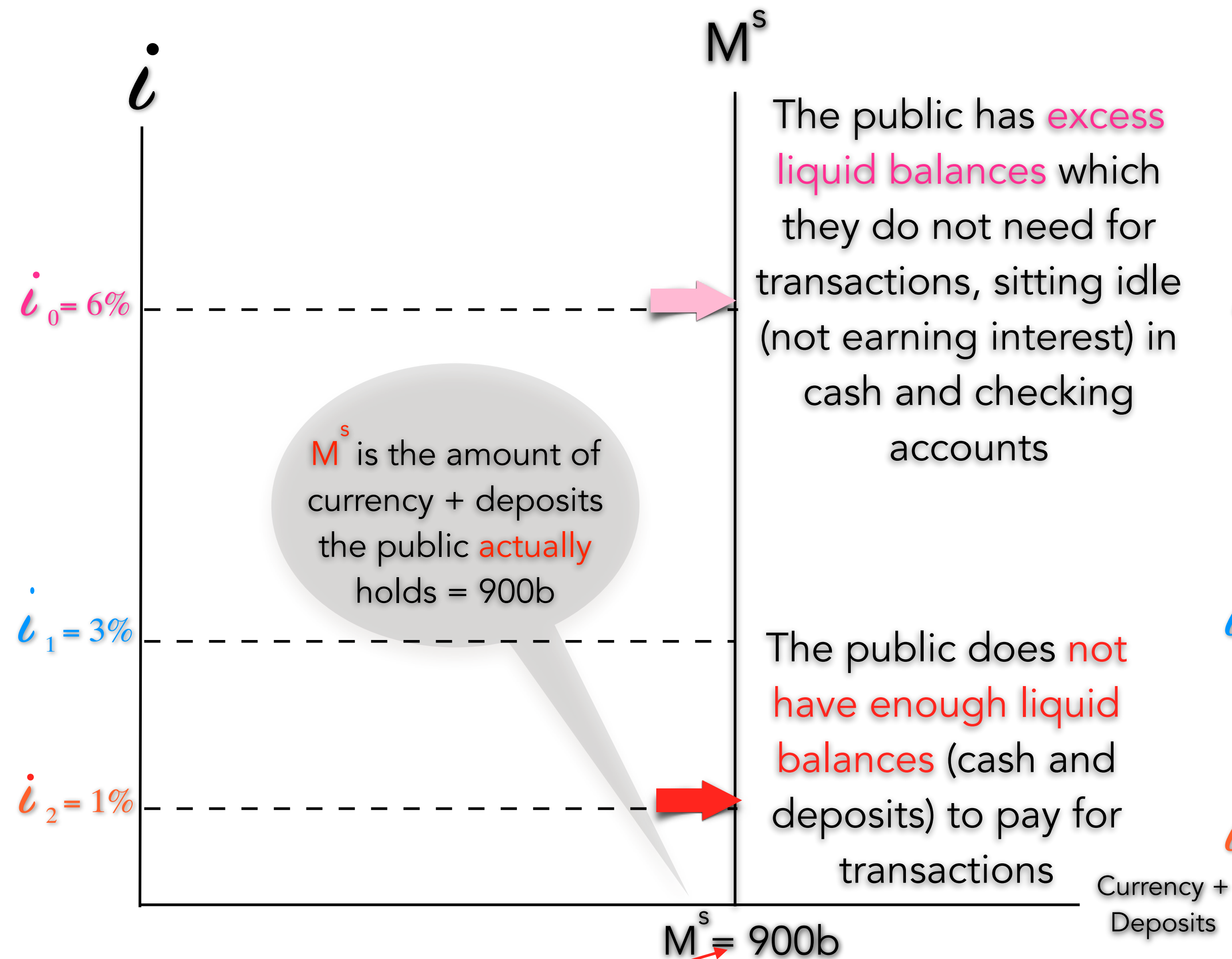


If the interest rate is 1% the public is holding (in cash and deposits) less liquid balances than they need for everyday transactions

The Money Supply

An example

The Money Demand



If the interest rate is **1%** the public is holding (in cash and deposits) **less liquid balances than they need** for everyday transactions