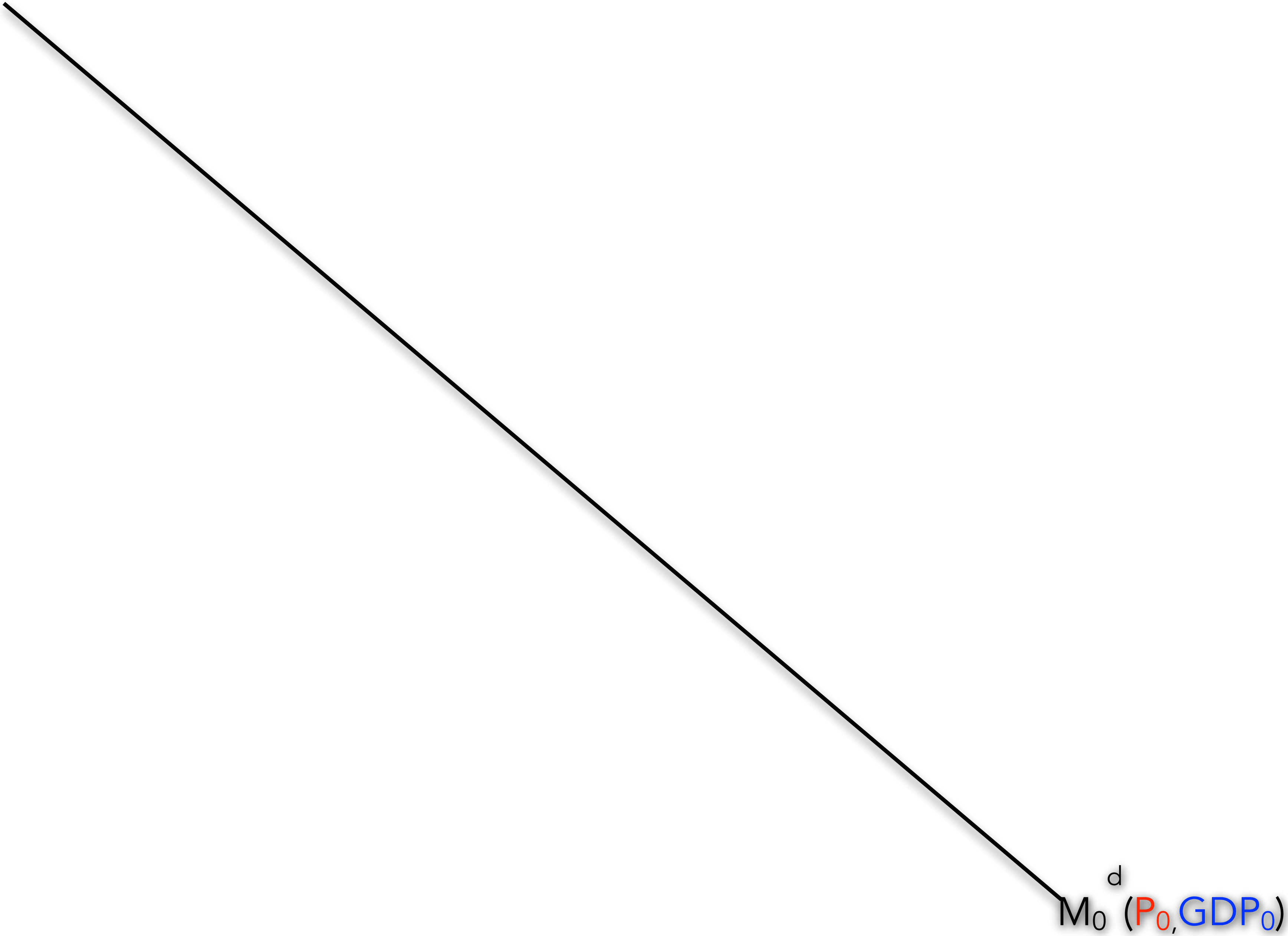
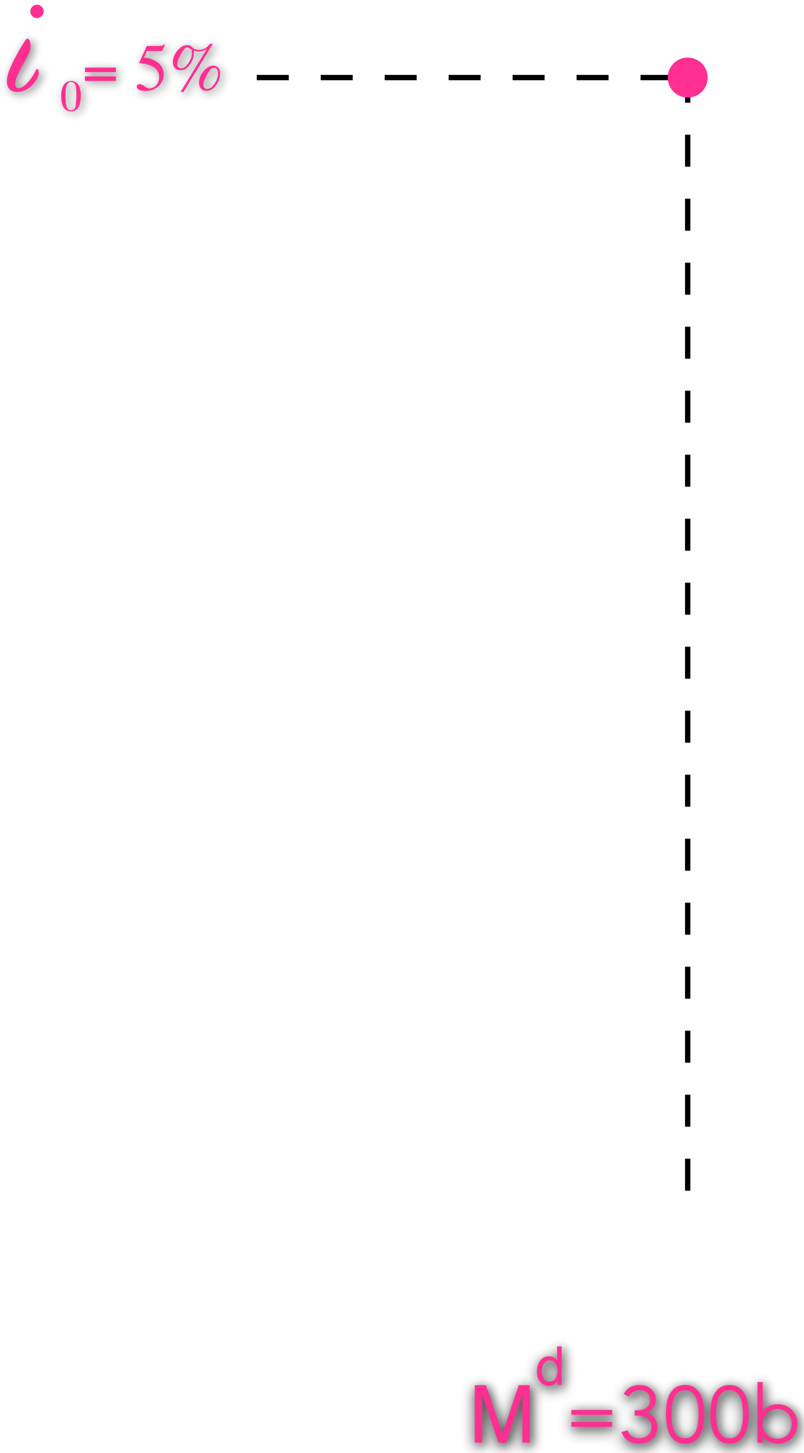
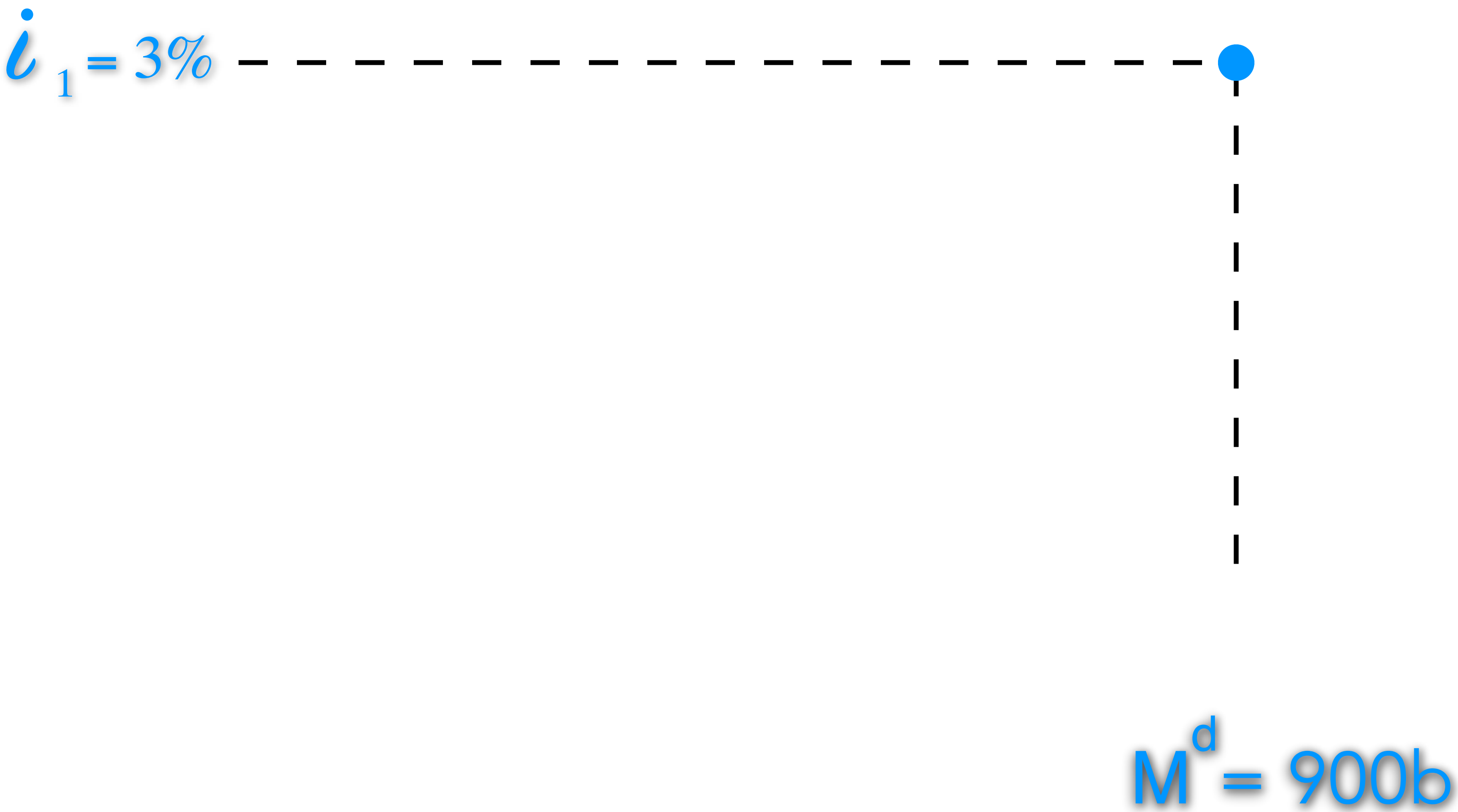
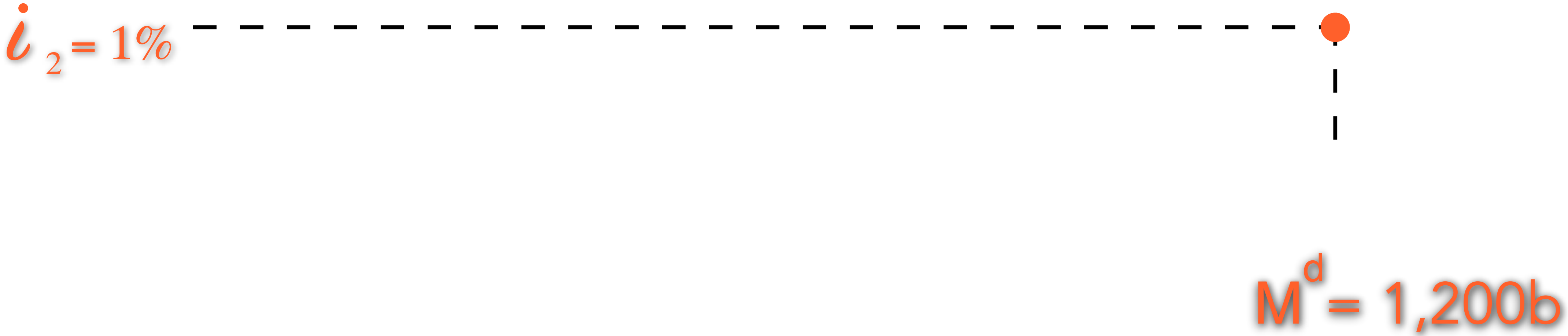
Currency+
Deposits

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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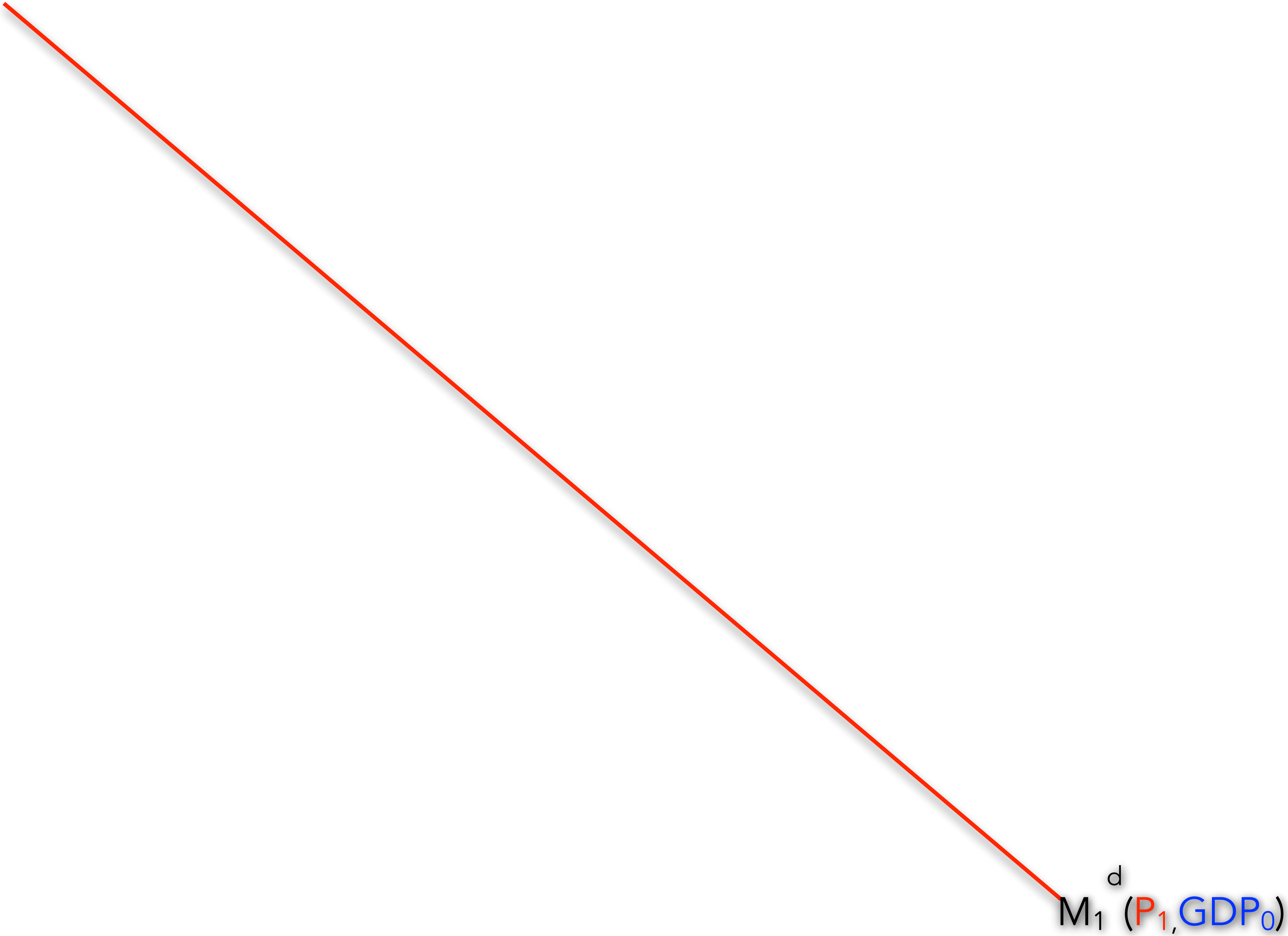
A rightward shift in the Demand for Money


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

The effect of an increase in the Price Level

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

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