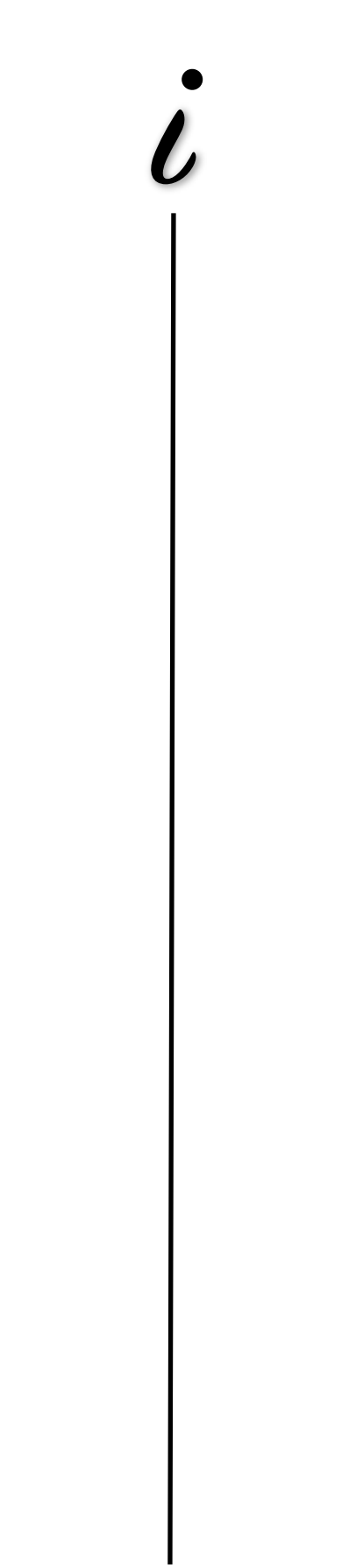
Currency
+ Deposits

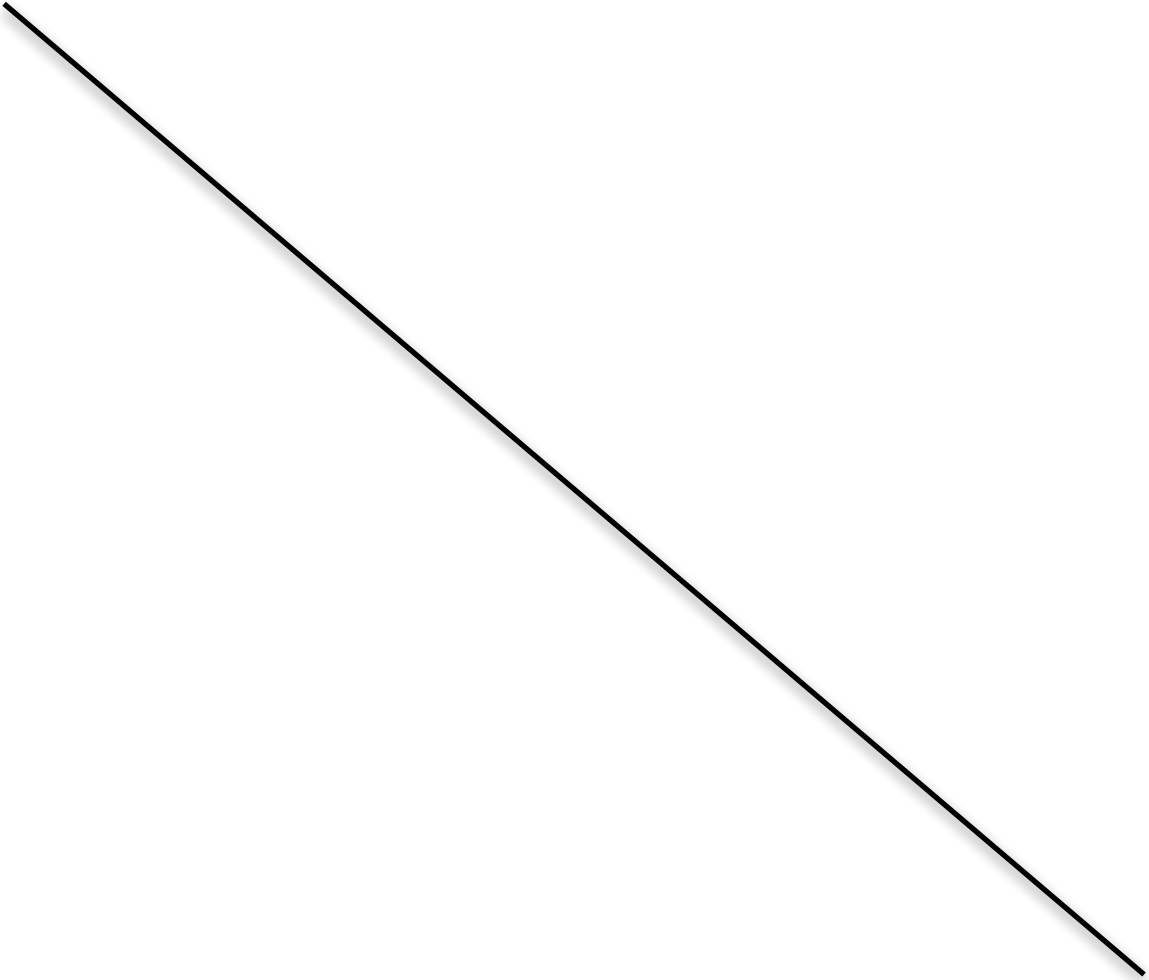


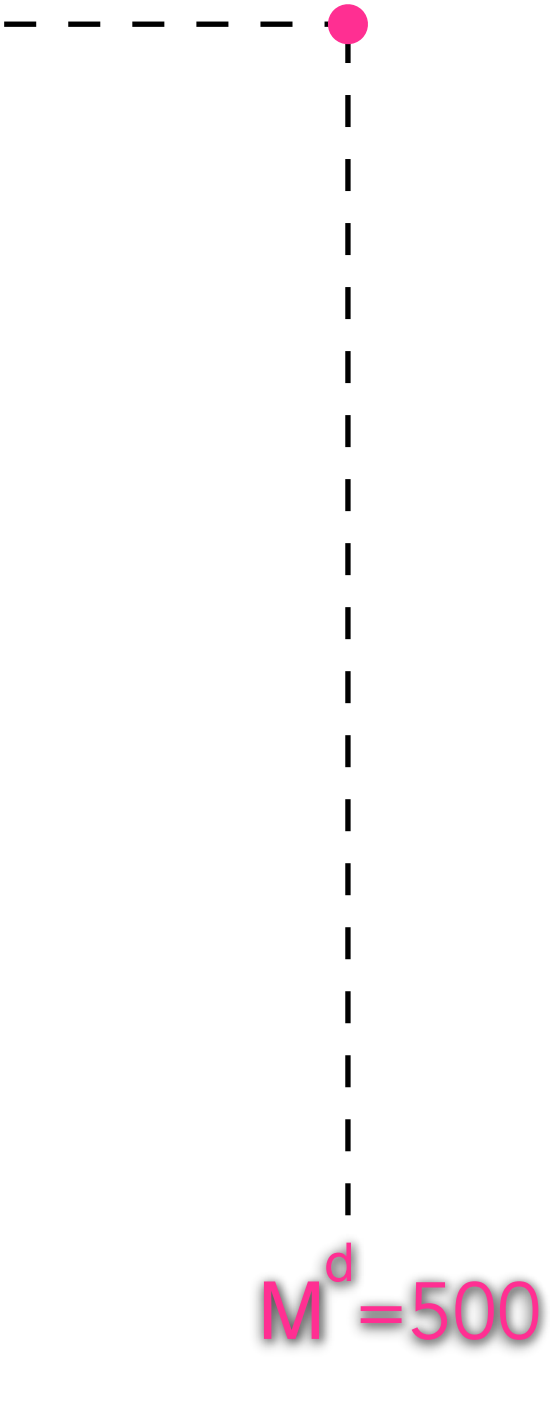
To calculate the amount of liquid balances (cash and deposits) needed for the entire U.S. economy, we need to know:

- The prices of all that is purchased and
- The total number of units purchased

A good proxy for prices is the CPI

A good proxy for quantities is real GDP




$M^d=500$

$M^d = 900$

For each interest rate, the demand for money M^d represents the need for liquid balances for a given price level (P_0) and a given GDP_0

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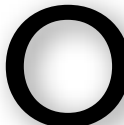

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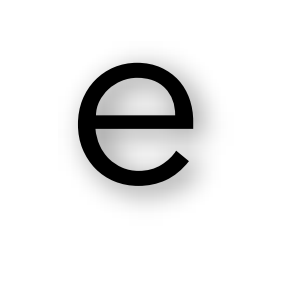
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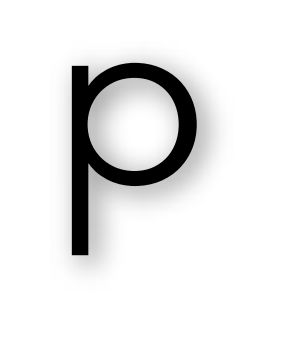

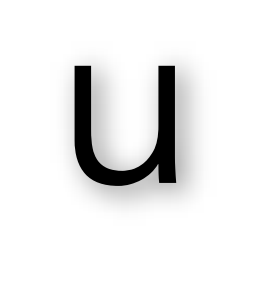

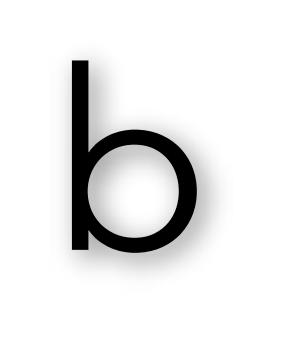

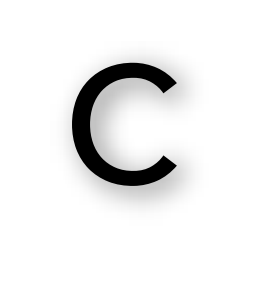
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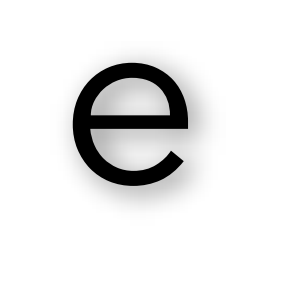

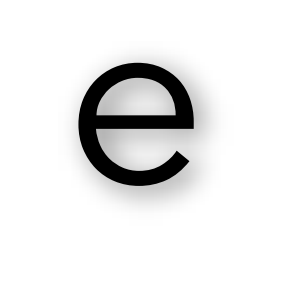
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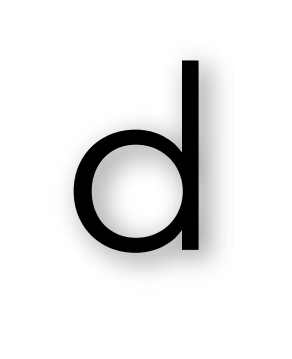

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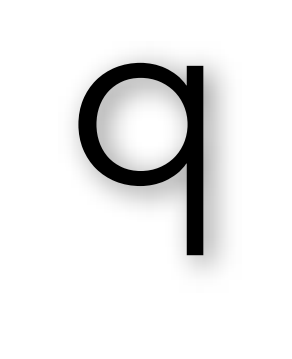

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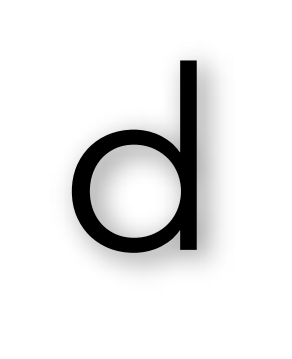

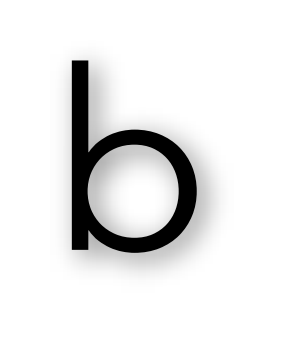

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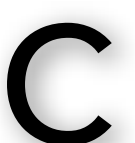

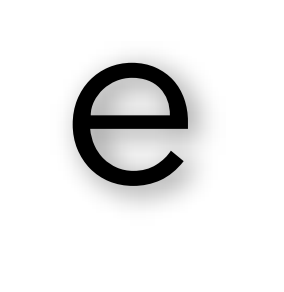
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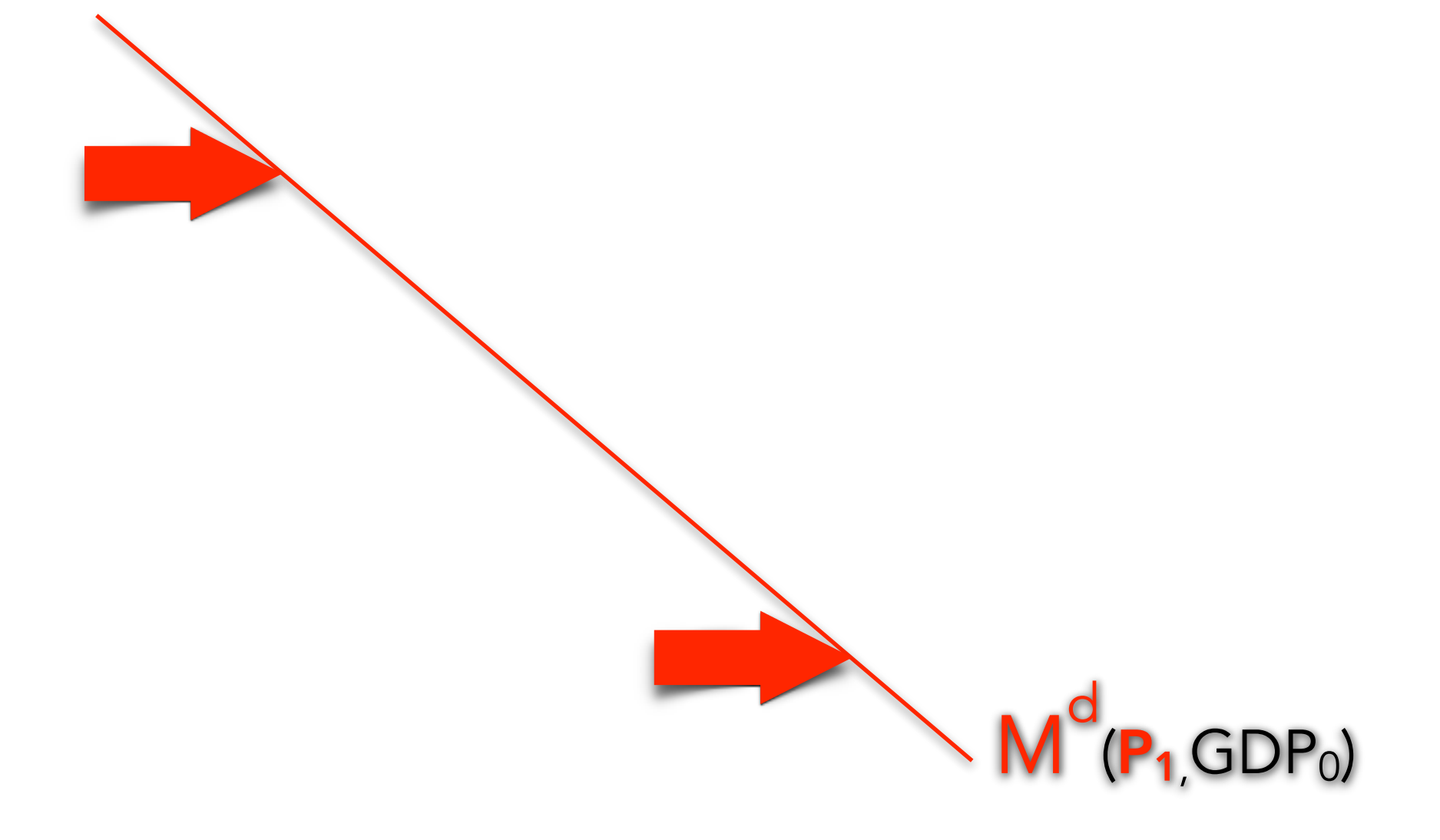
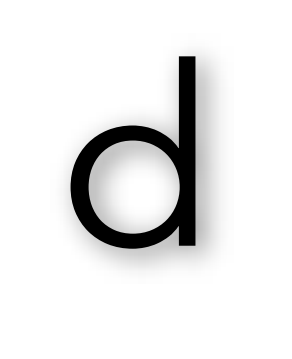
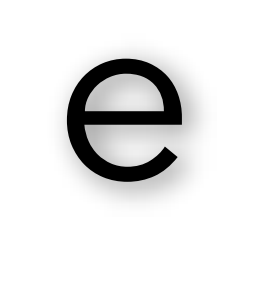
For all interest rates, the demand for liquid balances will be higher

A rightward shift in the Demand for Money


$M^d(P_1, GDP_0)$





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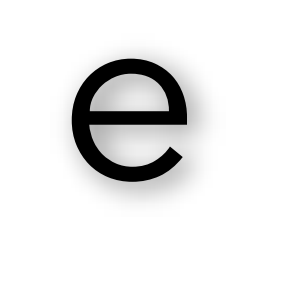

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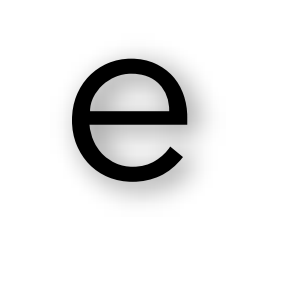

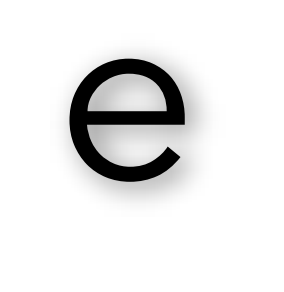

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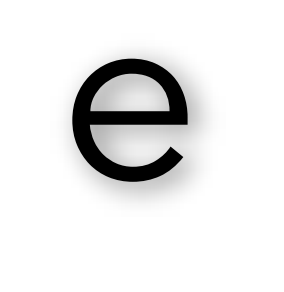

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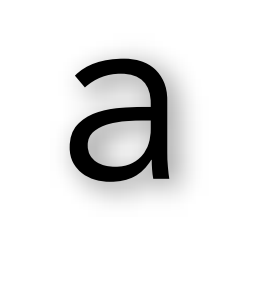
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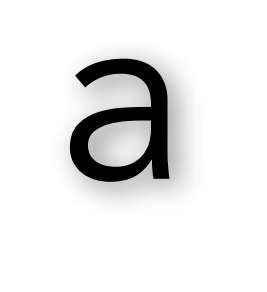
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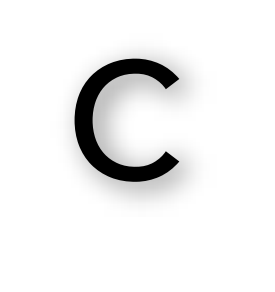
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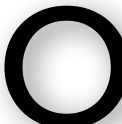

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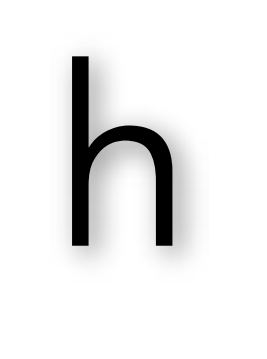
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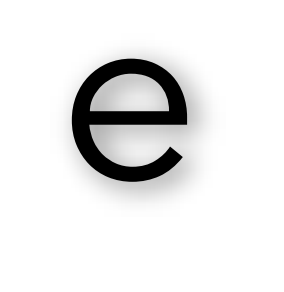

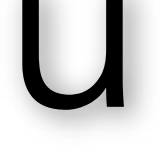

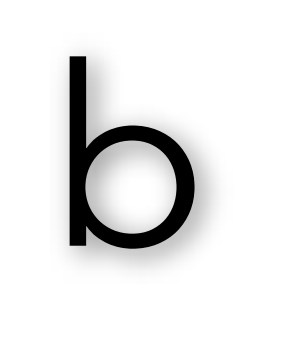

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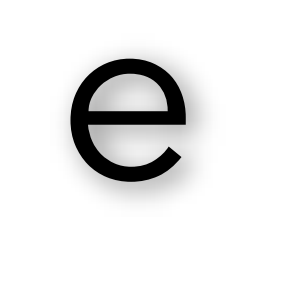
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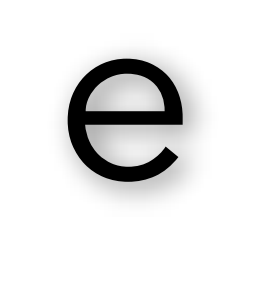

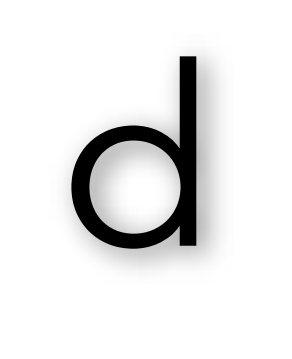

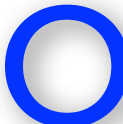

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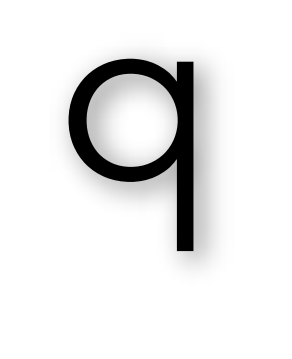

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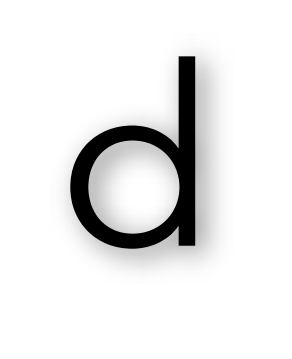

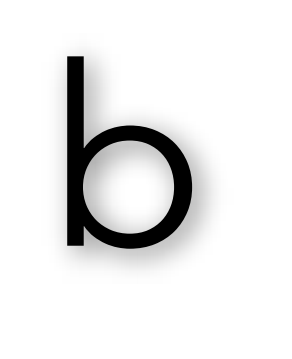

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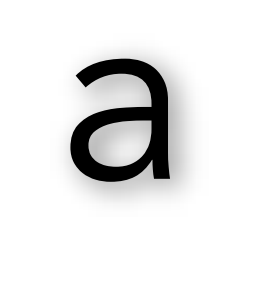
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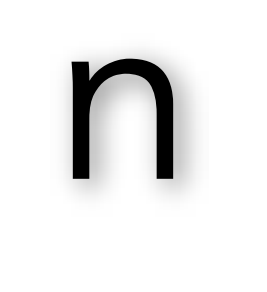
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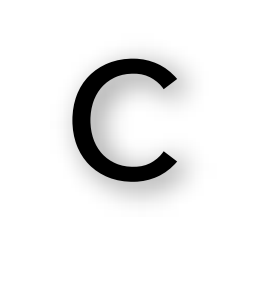
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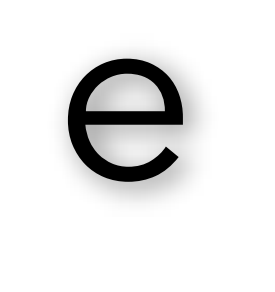
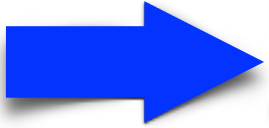
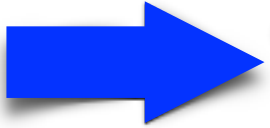
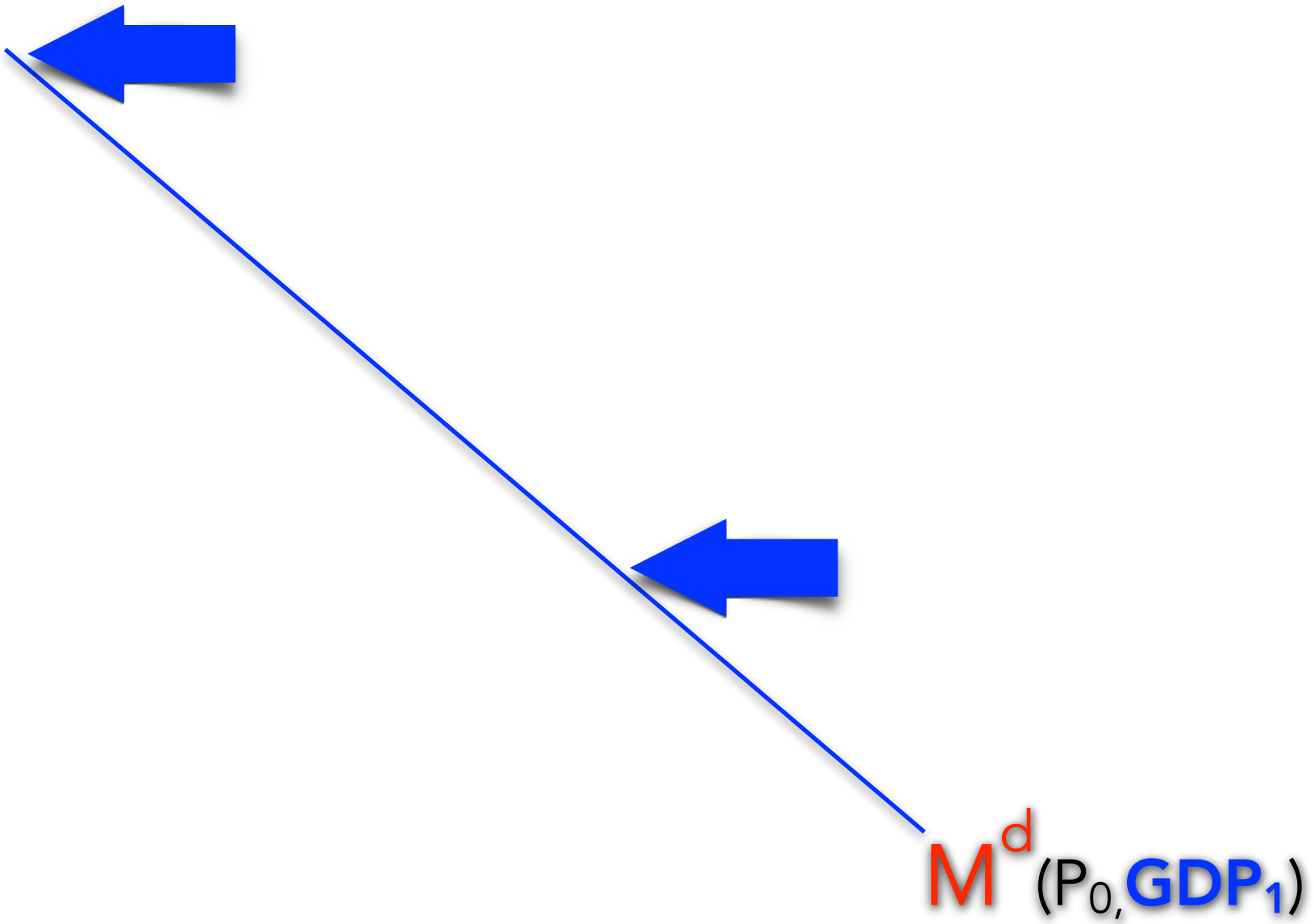




For all interest rates, the demand for liquid balances will be lower



A leftward shift in the Demand for Money


$M^d(P_0, GDP_1)$

How much money is needed for transactions?

If lunch is more expensive: price is $20/lunch, then I need to have 7x20=$140 in cash or check

If I buy lunch only 5 days a week, then I only need to have 5x15=$75 in cash or check

$$M^{d}_{(P_0, GDP_0)}$$

I need more money to pay for more expensive transactions

I need less money to pay for fewer transactions

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

If GDP decrease (fewer transactions) the public will need lower liquid balances

How much money is needed for transactions?

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

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

→ A rightward shift in the Demand for Money

If GDP decrease (fewer transactions) the public will need lower liquid balances

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

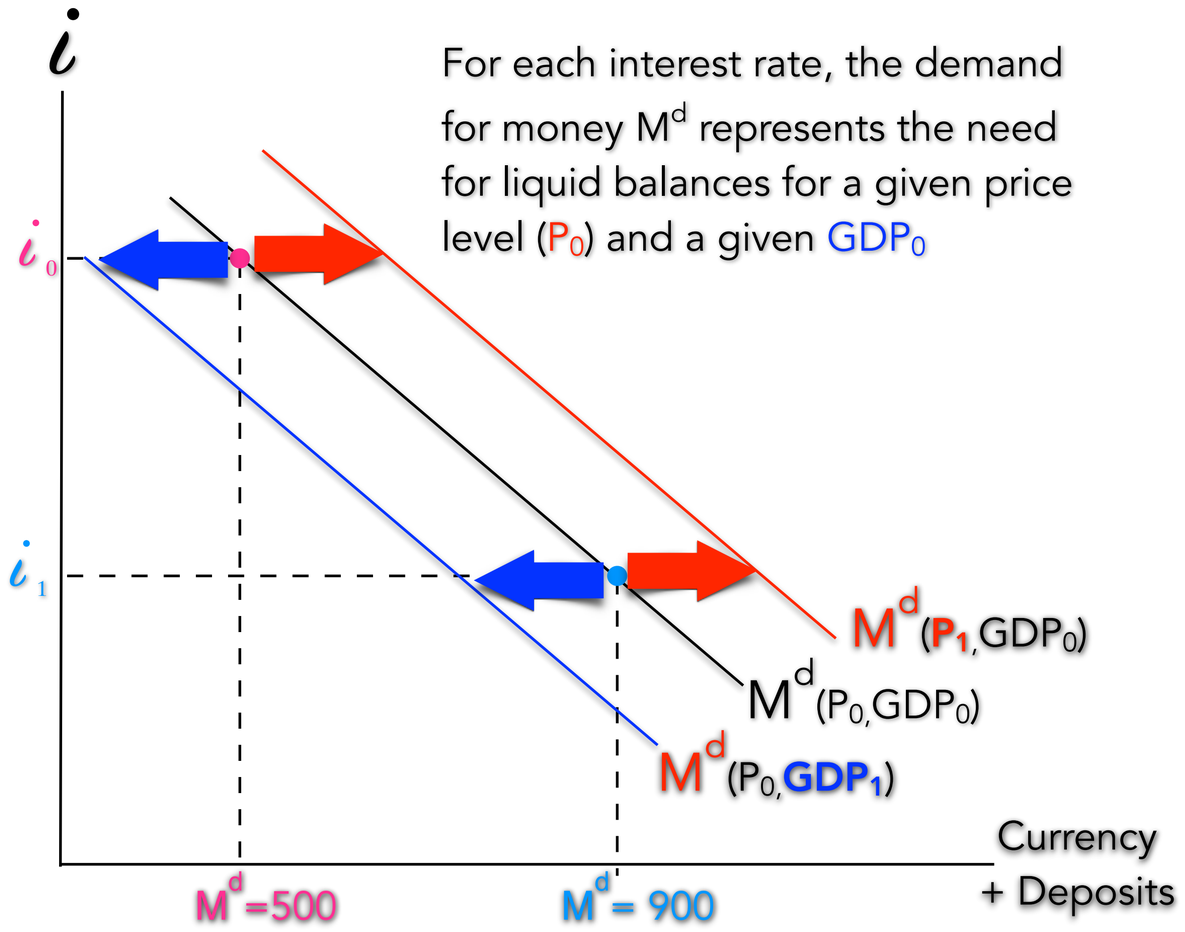
→ A leftward shift in the Demand for Money

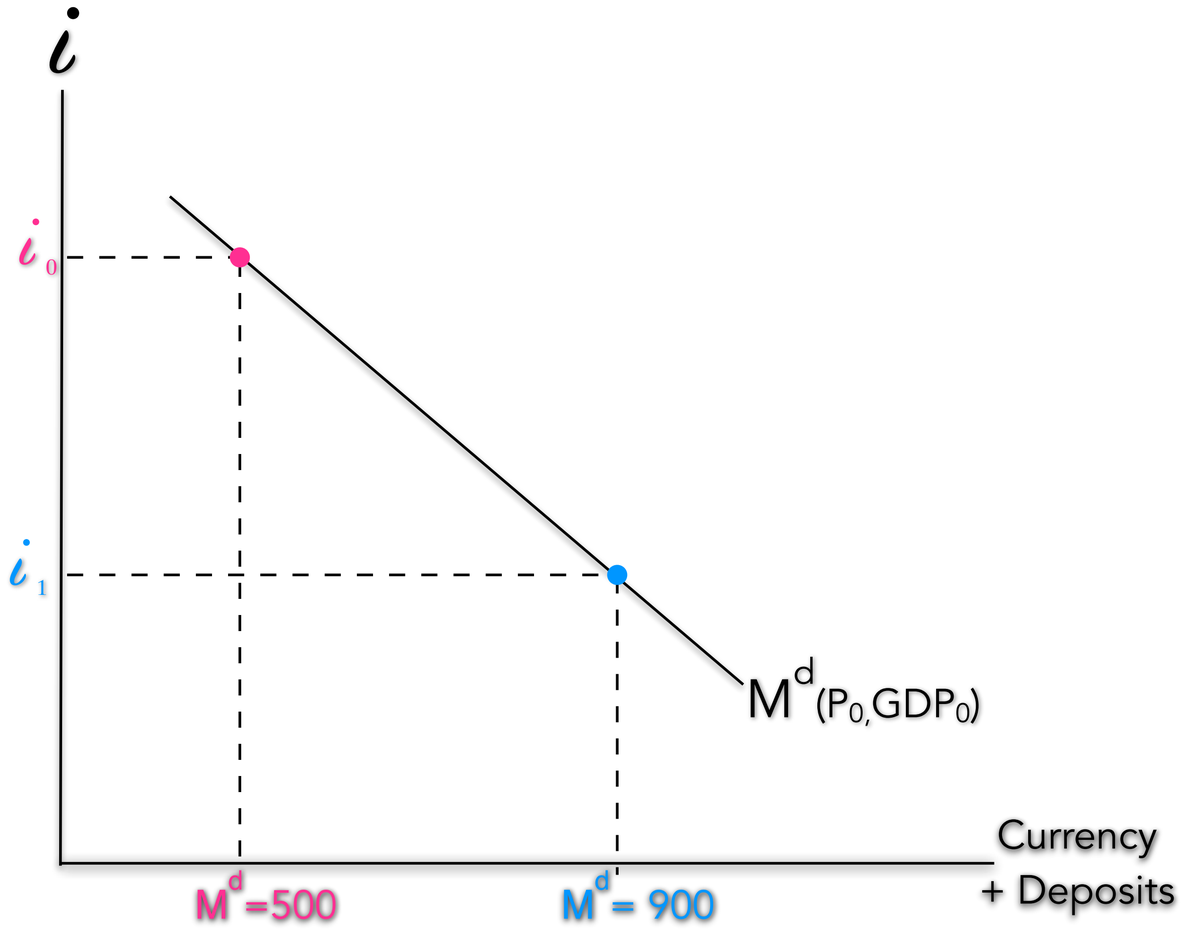
To calculate the amount of liquid balances (cash and deposits) needed for the entire U.S. economy, we need to know:

- The prices of all that is purchased and
- The total number of units purchased

A good proxy for prices is the CPI

A good proxy for quantities is real GDP



For each interest rate, the demand for money M^d represents the need for liquid balances for a given price level (P_0) and a given GDP_0

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