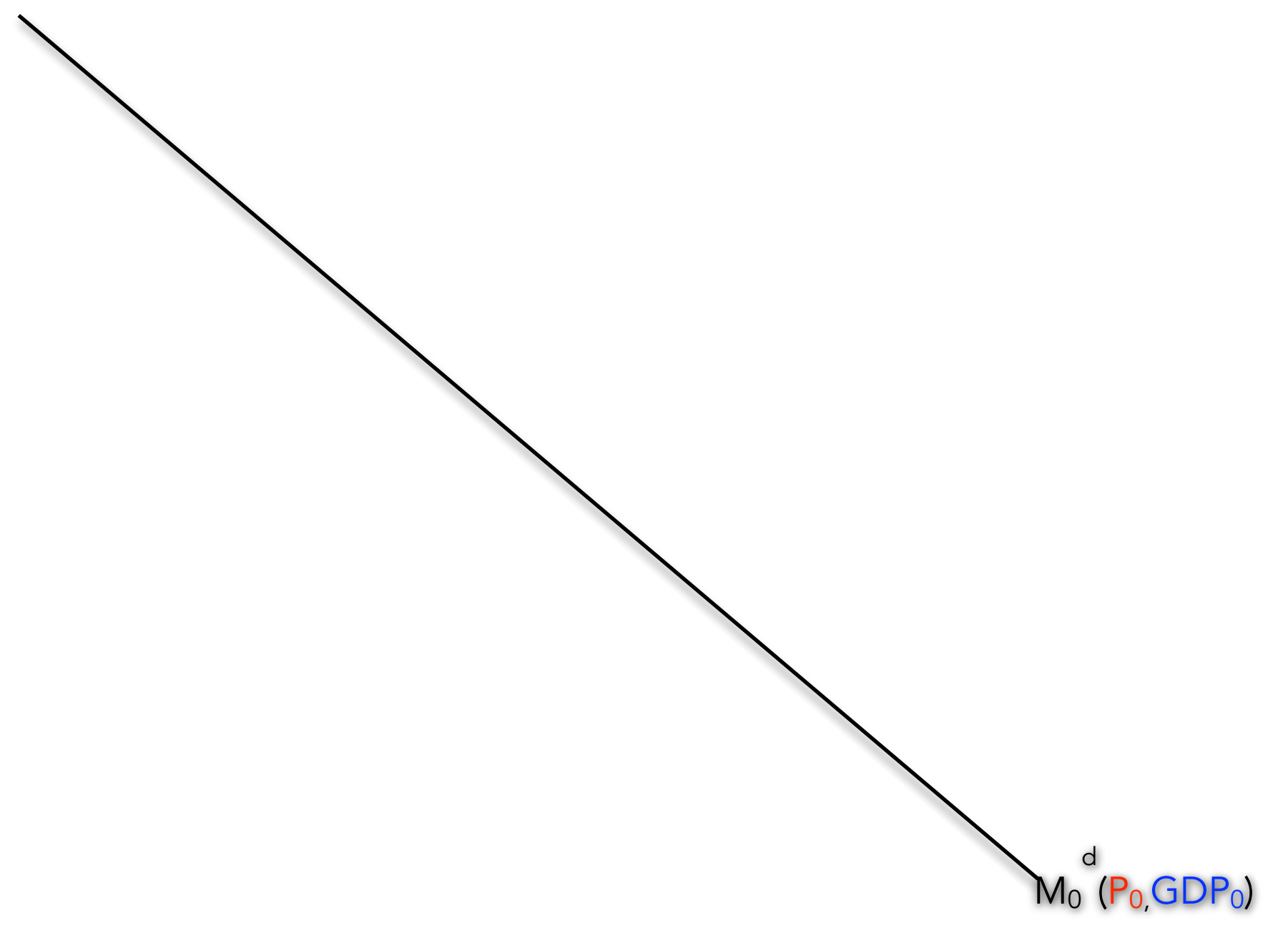


$i_1 = 1\%$ —————



i





$$i_0 = 5\%$$



$$M^d = 300b$$

$$i_1 = 3\%$$



$$M^d = 900b$$

$$i_2 = 1\%$$



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























2











a

S





G



P

Assume the Money Market

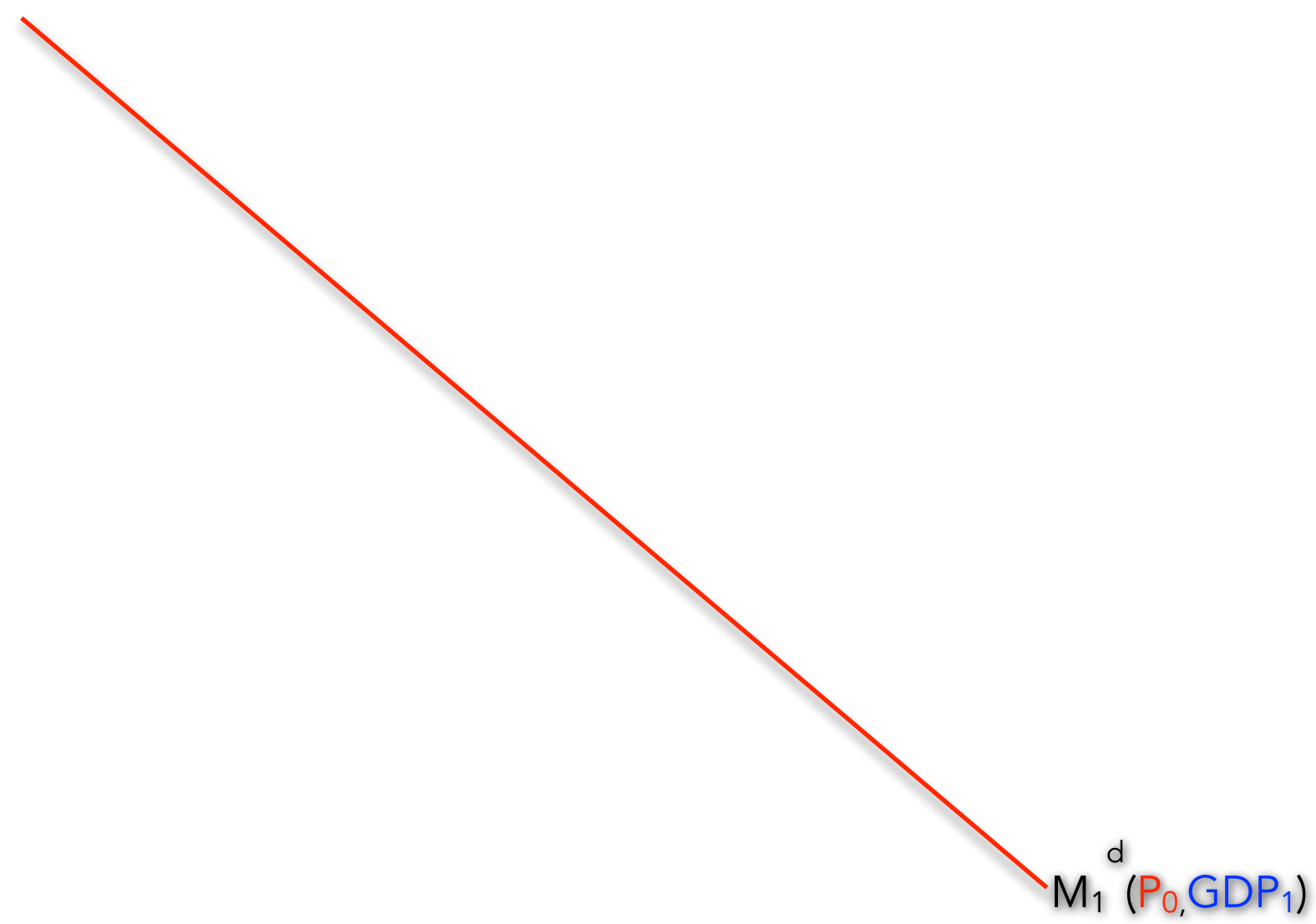


starts at equilibrium

M_0^s



$M_0^s = 900b$







G



P











a

S

e







W

e







2



S

2











S







e

P

U

b







W









e









W

e









u





b

a



a








S



A leftward shift in the
Demand for Money

excess liquid
balances at 3%

A blue bracket is positioned below the text "balances at 3%". Below the bracket is a horizontal dashed line consisting of seven short segments.



The interest rate will fall to
a new equilibrium at 1%

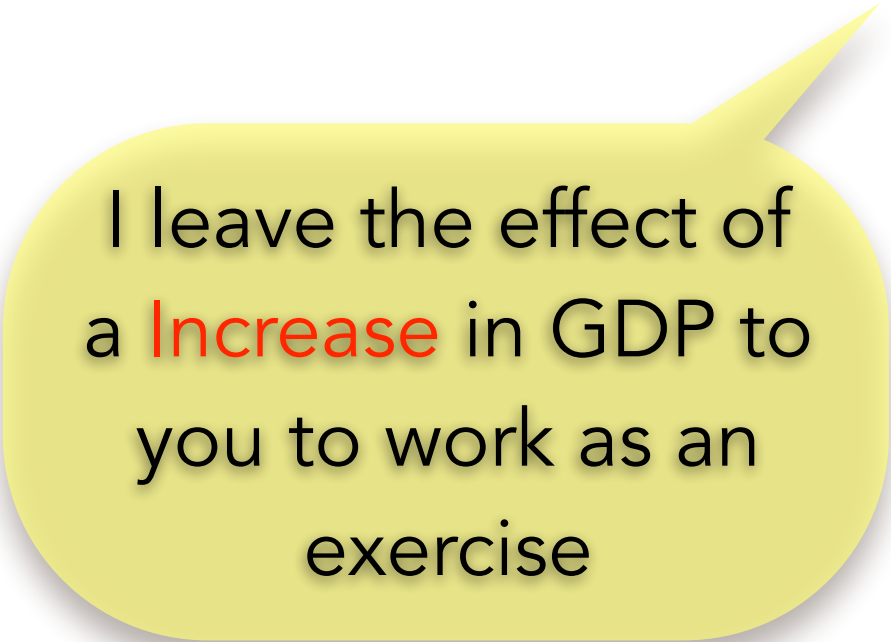
When there are excess liquid
balances, money is plentiful and
there is pressure for the interest
rate to fall





New
equilibrium

$$M^d = 9000b$$



I leave the effect of
a **Increase** in GDP to
you to work as an
exercise

The effect of a decrease in GDP

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

The effect of a decrease in GDP

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

I leave the effect of a **Increase** in GDP to you to work as an exercise

➔ The interest rate will **fall** to a new equilibrium at **1%**

