Monetary Policy Basics

Trevor Gallen

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Intro

1. Monetary policy is confusing for many laypeople
2. The purpose of this lecture is to get you up to speed on the broad ideas
3. Getting up to speed on the models is a course itself

Overview

1. Part 1: The Basic Supply and Demand of Money

2. Part 2: Adding Frictions

Part 1

- Why does money have value? Why can you exchange pieces of paper for real goods?
- Why is there a *demand for money*?
    1. You're required to accept them for debts paid (legal tender)
    2. Government creates demand for them via taxes (!)
    3. Convenient coordination point (additional demand induced by existing demand)
- Why do you use dollars, rather than Bitcoin or Yen? (is much of "convenience yield"?)

Part 1

- It's easy, but perhaps a bit of a cheat, to start *in medias res*
- People have some *real* demand for money. What determines how much cash they must hold?
- Let:
  - M^D be the amount of dollars a household decides to hold at a point in time
  - P be the price level (dollars per good)
  - $L(Y, i)$ be real money demand (goods)
  - Y be real income
  - i be nominal interest rate
- Then we write:

$$M^D = PL(Y, i)$$