# The Money Market

- The market where the Fed and the users of money interact thus determining the nominal interest rate (i%).
- Money Demand (MD) comes from households, firms, government and the foreign sector.
- The Money Supply (MS) is determined only by the Federal Reserve.

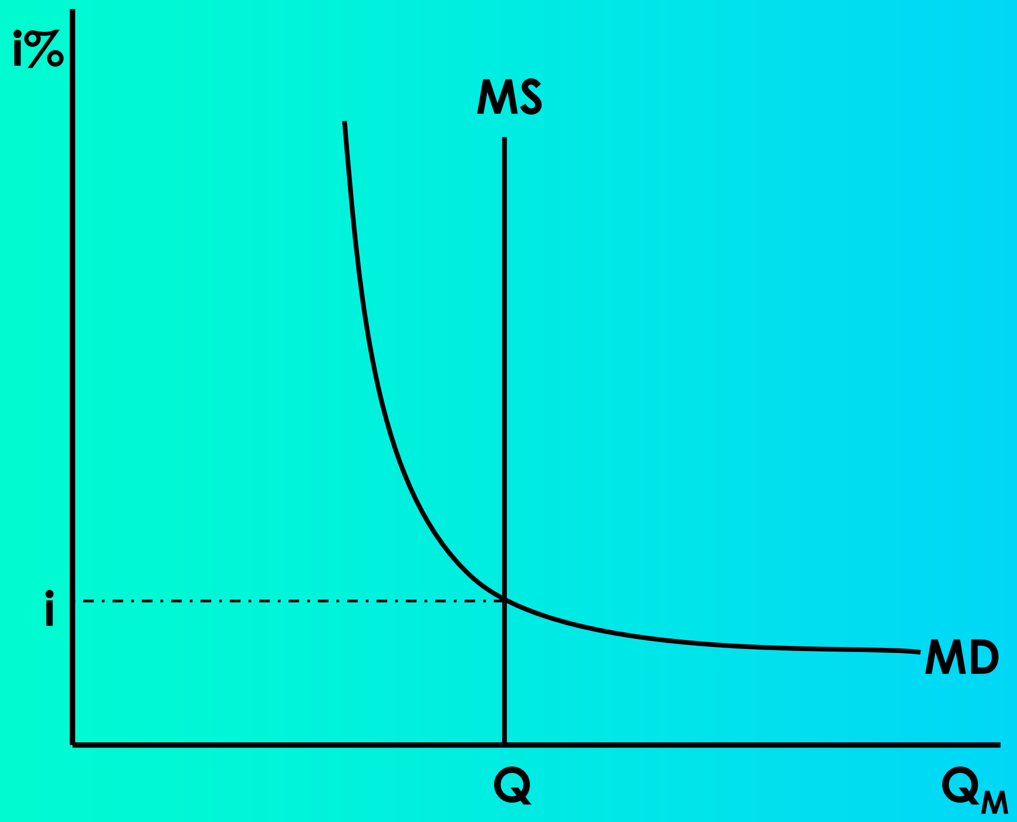
# Money Demand

- <u>Transaction Demand</u> – D for $ as a medium of exchange
- <u>Asset Demand</u> – D for $ as a store of value (dependent on the interest rate).
- <u>Total Money Demand</u> – (MD) is downward sloping because at high i% people are less inclined to hold $ and more inclined to hold stocks & bonds. At lower i% people sacrifice less when they hold $.

# Money Supply

- The MS is determined by the Fed b/c the Fed has a monopoly over the supply of money.
- The Fed’s monopoly is the reason for the vertical MS curve

# The Money Market

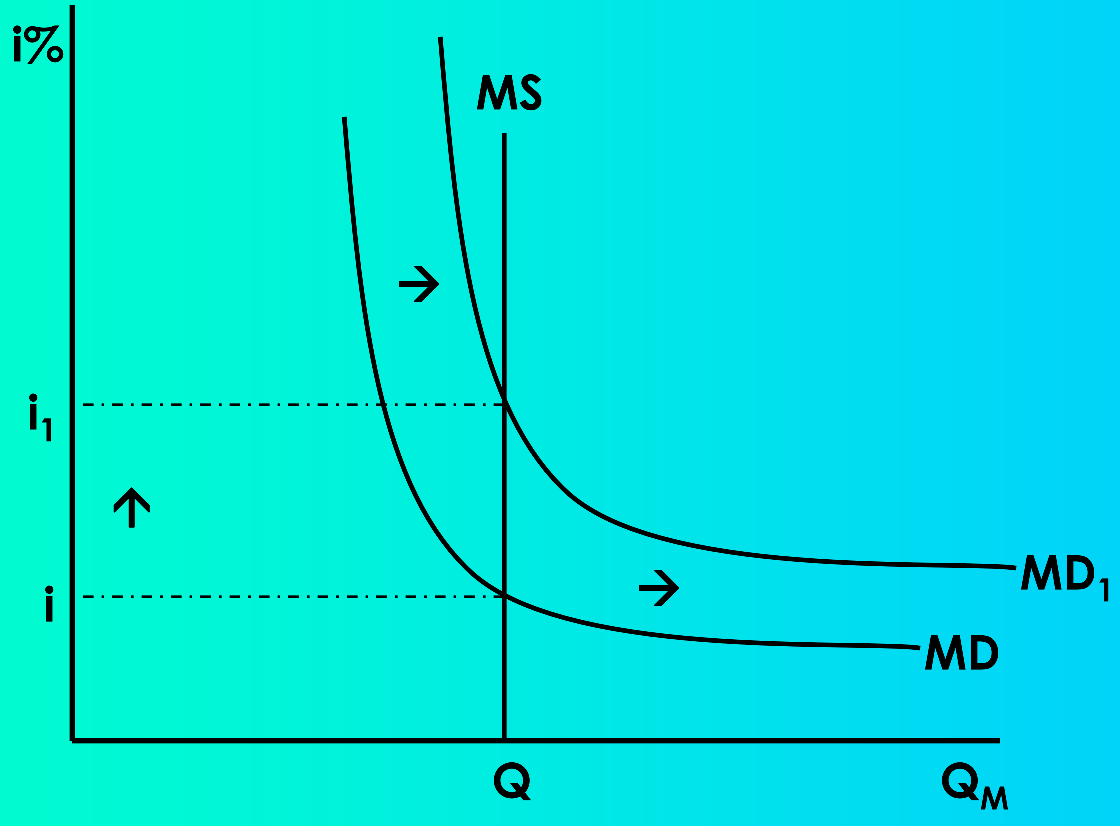



The equilibrium of *MS* & *MD* determines the nominal interest rate (i%). *MD* is downward sloping because the nominal interest rate is the opportunity cost of holding money. *MS* is vertical because it is independent of the interest rate.

# Changes in Money Demand

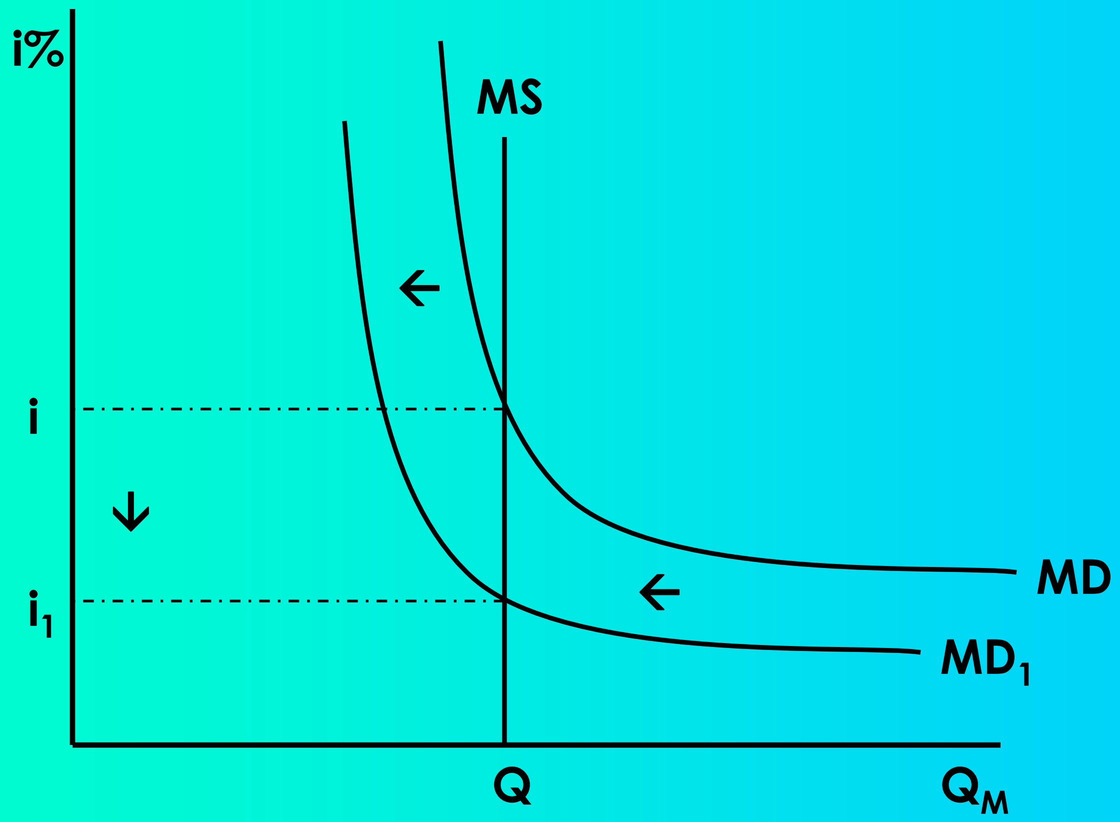
- Money Demand is dependent on both the Price Level and Real GDP which together comprise the Nominal GDP
  - Nominal GDP↑ .: MD→ .: i%↑
  - Nominal GDP↓ .: MD← .: i%↓
- Increases in income = MD increase
  - People will demand money for transactions

# Increase in Money Demand




**MD→ .: i%↑**

# Decrease in Money Demand




**MD← .: i%↓**

# Changes in the Money Supply

## Only the Fed determines the money supply

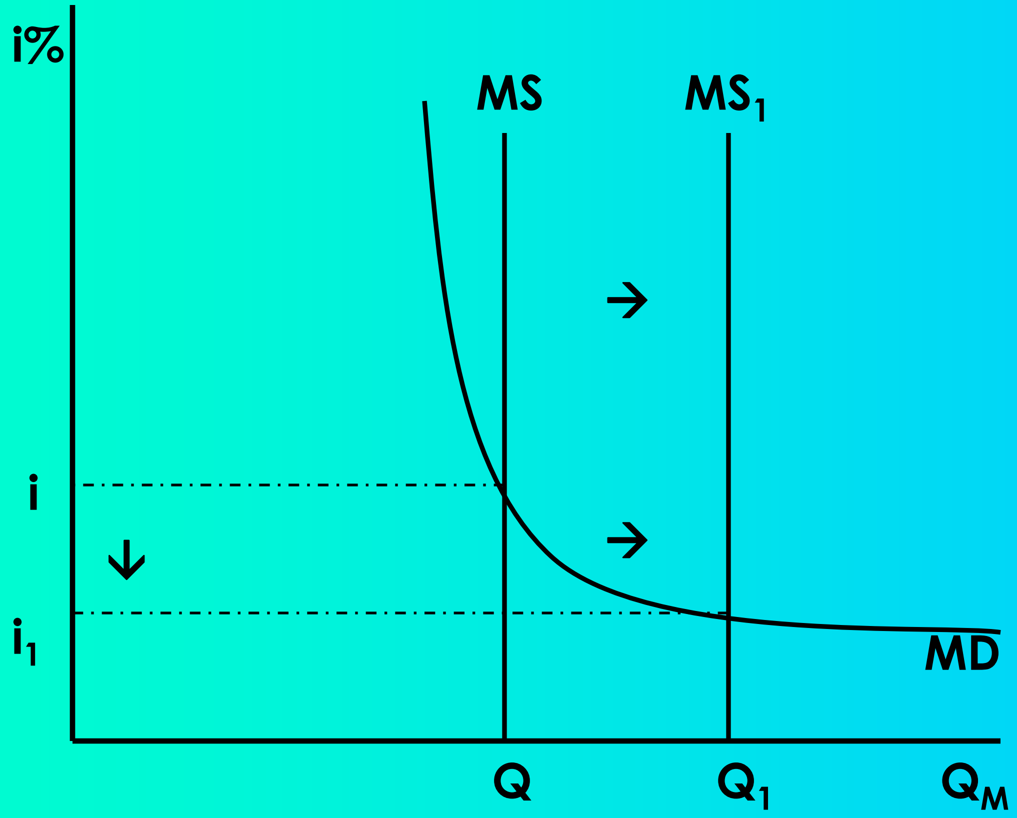
- <u>Contractionary Monetary Policy MS← .: i%↑</u>

Res. Ratio ↑
Disc. Rate ↑
Sell Bonds = small bucks = MS ↓

# Expansionary Monetary Policy
# MS→ .: i%↓

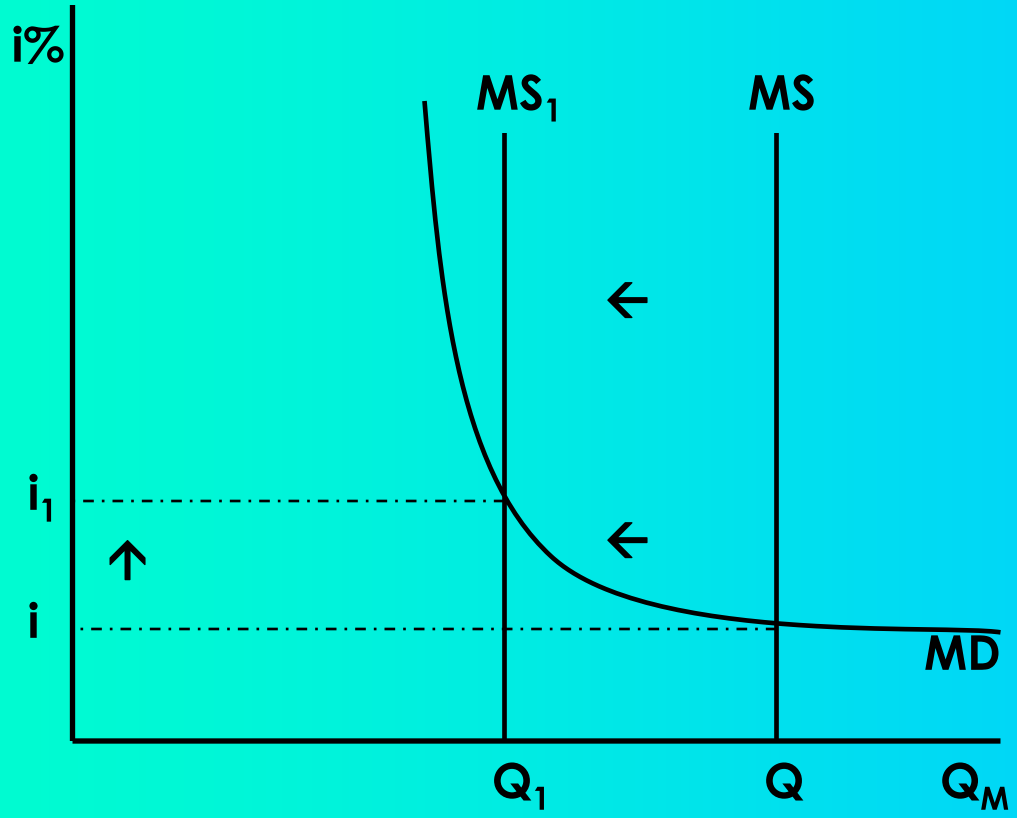
- Res. Ratio ↓
- Disc. Rate ↓
- Buy Bonds = Big bucks = MS ↑

# Increase in Money Supply




**MS→ .: i%↓**

# Decrease in Money Supply




MS← .: i%↑

# Money Market Practice

1. Show how an increase in bond purchases by the Fed would affect i% and Qm
2. How would an increase in national income affect i% and QM?
3. Who the impact of a decision by the private, public and foreign sector to spend less

# Money Market Practice cont..

4. Show how an increase in the rr would affect the i% and QM
5. Using a correctly labeled Money market graph linked to an ID curve graph, show the impact of G borrowing on the i%, Qm, and the level of Ig in the economy.

# Money Market practice

6. Using a correctly labeled Money market graph linked to an ID curve graph, show the impact of an OMO sale of bonds on the i%, Qm, and the level of Ig in the economy.