

BS2551 Money Banking and Finance

Seminar 5: Money Demand

Suppose that a person's wealth is £50,000 and that her yearly income is £60,000. Also suppose that her money demand function is given by:

$$Md = \text{£}Y(0.35 - i)$$

- a) What is her demand for money when the interest rate is 5%, 10%, 20%.
- b) Describe the effect of the interest rate on money demand. Is this consistent with the theoretical literature?
- c) Suppose the interest rate is 5%. In percentage terms, what happens to her demand for money if her yearly income is reduced by 50%?
- d) Suppose the interest rate is 20%. In percentage terms, what happens to her demand for money if her yearly income is reduced by 50%?
- e) Summarize the effect of income on money demand. How does it depend on the interest rate?

- f) Derive the demand for bonds. What is the effect of a 10% interest rate rise on the demand for bonds?

- g) What is the effect of an increase in wealth on money demand and bond demand?