Exercise walk-through

The Money Market ▪ 4.5

eXercise

You must be able to

- describe the **demand for money 货币需求** as downward-sloping in the nominal interest rate
- treat the **money supply 货币供给** as set by the central bank (vertical)
- determine the **equilibrium nominal interest rate** and analyse shifts

Method — Money demand

The demand for money slopes **downward** in the nominal interest rate: a higher rate is a bigger opportunity cost of holding cash, so people hold **less**.

Method — Money supply

Set by the **central bank**, so it is drawn **vertical** (independent of the interest rate).

Method — Equilibrium

Where money demand meets money supply — this fixes the equilibrium **nominal interest rate**. More money supply $\rightarrow$ lower rate.

Practice 2.1 ▪ 1 mark

State why the demand for money slopes downward.

Solution 2.1

Method: Money demand

Worked steps

a higher interest rate raises the opportunity cost of holding money, so less is demanded **B1**.

Practice 2.2 ▪ 1 mark

State the shape of the money-supply curve, and why.

Solution 2.2

Worked steps

vertical, because it is set by the central bank regardless of the interest rate B1.

Practice 2.3 ▪ 1 mark

State what happens to the interest rate if the central bank increases the money supply.

Solution 2.3

Method: Money supply

Worked steps

it falls **B1**.

Exam-style 3.1 ▪ 1 mark

The money-supply curve is

A upward-sloping

B downward-sloping

C vertical

D horizontal

Solution 3.1

- **A** upward-sloping
- **B** downward-sloping
- **C** vertical ✓
- **D** horizontal

Worked steps

C.

Exam-style 3.2 ▪ 1 mark

An increase in the money supply lowers the

A price level directly

B nominal interest rate

C real GDP directly

D reserve ratio

Solution 3.2

A price level directly

B nominal interest rate ✓

C real GDP directly

D reserve ratio

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

The central bank increases the money supply.
(a) State the effect on the nominal interest rate.
(b) State the effect on investment spending.
(c) State the effect on aggregate demand.

Solution 3.3

Worked steps

(a) it falls **B1**. (b) investment rises **B1**. (c) AD rises **B1**.