BS2551 Money Banking and Finance

Seminar 5: Money Demand Solutions

a)

i=0.05, Md=60,000*(0.35-0.05)=£18,000.

i=0.10, Md=60,000*(0.35-0.10)=£15,000.

i=0.20, Md=60,000*(0.35-0.20)=£9,000.

b) Money demand decreases when interest rates increases, consistent with the theory.

c) Money demand is reduced by 50%.

d) Money demand is reduced by 50%.

e) A 1% increase (decrease) in income leads to a 1% increase (decrease) in money demand. The effect is not dependant on the interest rate.

f) Bond Demand = 50,000-60,000(0.35-i).

Suppose I =10%, Bond demand = £35,000.

Increase of 10% to 20%, Bond demand = £41,000.

Therefore increase in interest rate of 10%, Bond demand increases by £6,000.

g) Wealth increases bond demand but has no effect on money demand.