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Zenglibao: An Internet Money Market Fund Run by Tianhong Asset Management Co., Ltd.

The Money Market

- Why would you want to have money in your pocket?
- What would cause you to have more money in your pocket today than you had yesterday?

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The Opportunity Cost of Holding Money

- It is convenient to hold money in your pocket because it allows you to conveniently make purchases.
  - The price of that convenience is that money in your pocket earns no interest.
- **The Rule: the higher the short-term interest rate, the higher the opportunity cost of holding money**
  - the lower the short-term interest rate, the lower the opportunity cost of holding money.

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Long- Term Interest Rates

- Why don't we consider long-term interest rates like 10-year CDs as the opportunity cost of holding money?
  - Because we hold money to make transactions in the short term. Therefore we must consider the opportunity cost in the short term, not the long term.

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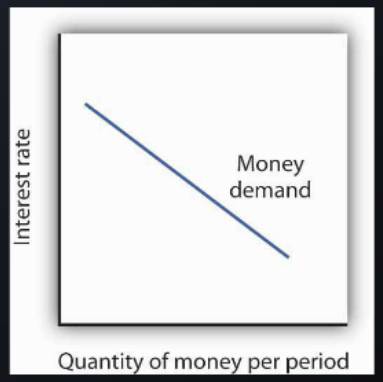
The Money Demand Curve

- We assume that in a short period of time, there will be virtually no inflation, so we use the **nominal** interest rate.
- When the interest rate rises, the opportunity cost of holding money rises, so the quantity of money demanded will fall.



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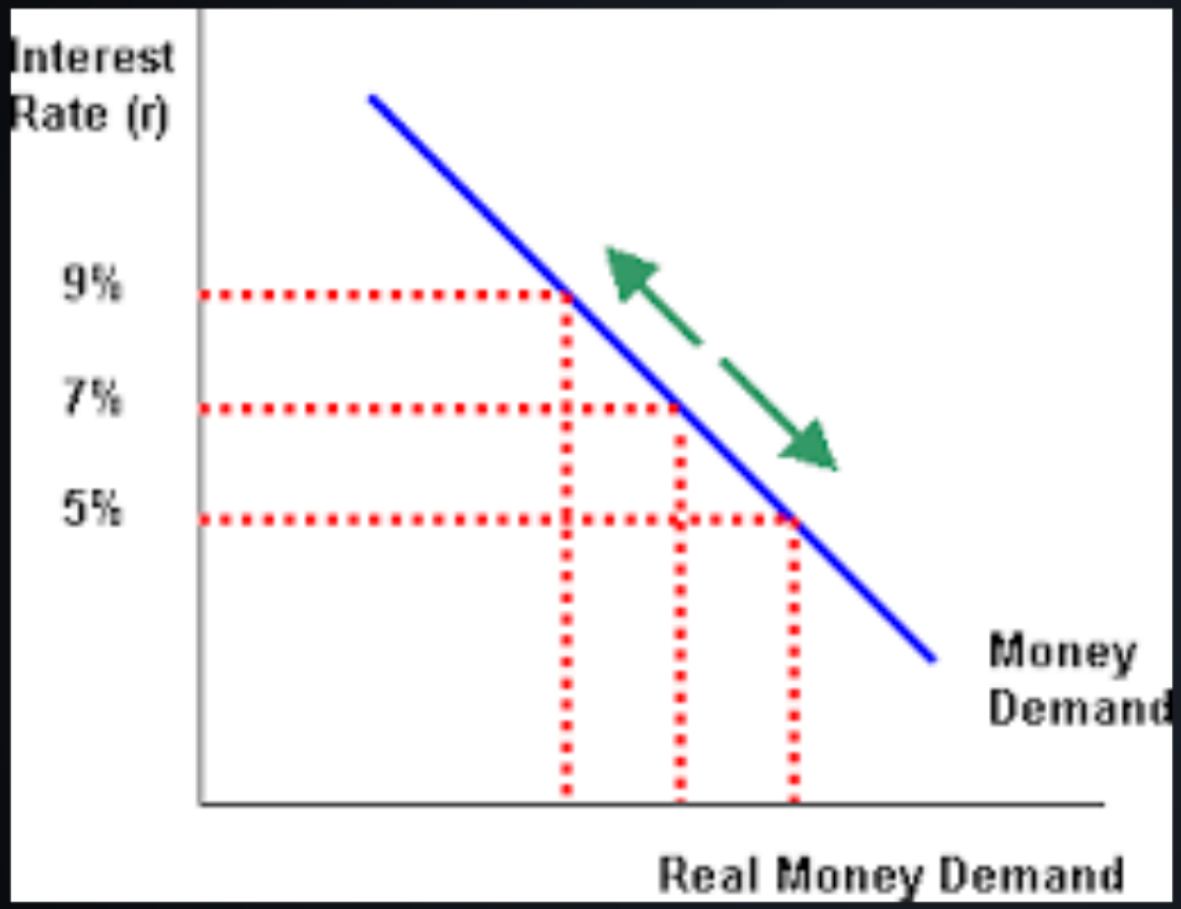

An increase in the nominal interest rate will cause a movement upward along the money demand curve.

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Shifts of the Money Demand Curve

1. changes in the aggregate price level
2. changes in real GDP
3. changes in banking technology
4. changes in banking institutions

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1. Changes in the Aggregate Price Level

- higher prices increase the demand for money (a rightward shift of the MD curve)
- the demand for money is proportional to the price level.
    - if the aggregate price level rises by 20%, the quantity of money demanded at any given interest rate, also rises by 20%.

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