

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**

• A fundamental principle of economics is that the opportunity cost of doing something is the value of the next best alternative that you give up.

• The opportunity cost of holding money is the interest foregone on the money held.

• The higher the interest rate, the higher the opportunity cost of holding money.

• The higher the opportunity cost, the lower the opportunity cost of holding money.

TheCaseSolutions.com

**The Money Demand Curve**

• The money demand curve shows the relationship between the interest rate and the quantity of money demanded.

• The money demand curve is downward sloping.

• The money demand curve is influenced by the interest rate, the level of income, and the level of technology.

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**Shifts of the Money Demand Curve**

1. An increase in the interest rate will shift the money demand curve to the left.

2. An increase in the level of income will shift the money demand curve to the right.

3. An increase in the level of technology will shift the money demand curve to the right.

TheCaseSolutions.com

**Money and Interest Rates**

• The relationship between the interest rate and the quantity of money demanded is inverse.

• The relationship between the interest rate and the quantity of money supplied is vertical.

• The equilibrium interest rate is determined by the intersection of the money demand curve and the money supply curve.

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**The Equilibrium Interest Rate**

• The equilibrium interest rate is determined by the intersection of the money demand curve and the money supply curve.

• The equilibrium interest rate is the interest rate at which the quantity of money demanded equals the quantity of money supplied.

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• The opportunity cost of holding money is the interest foregone on the money held.

• The higher the interest rate, the higher the opportunity cost of holding money.

• The higher the opportunity cost of holding money, the lower the demand for money.

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• The money demand curve is downward sloping.

• The money demand curve is derived from the opportunity cost of holding money.

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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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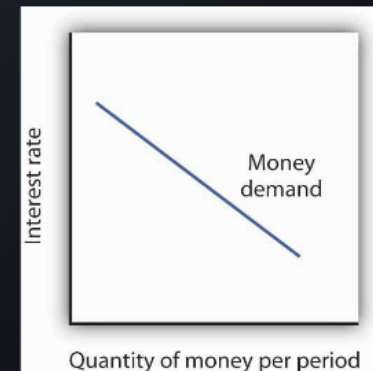
# Long- Term Interest Rates

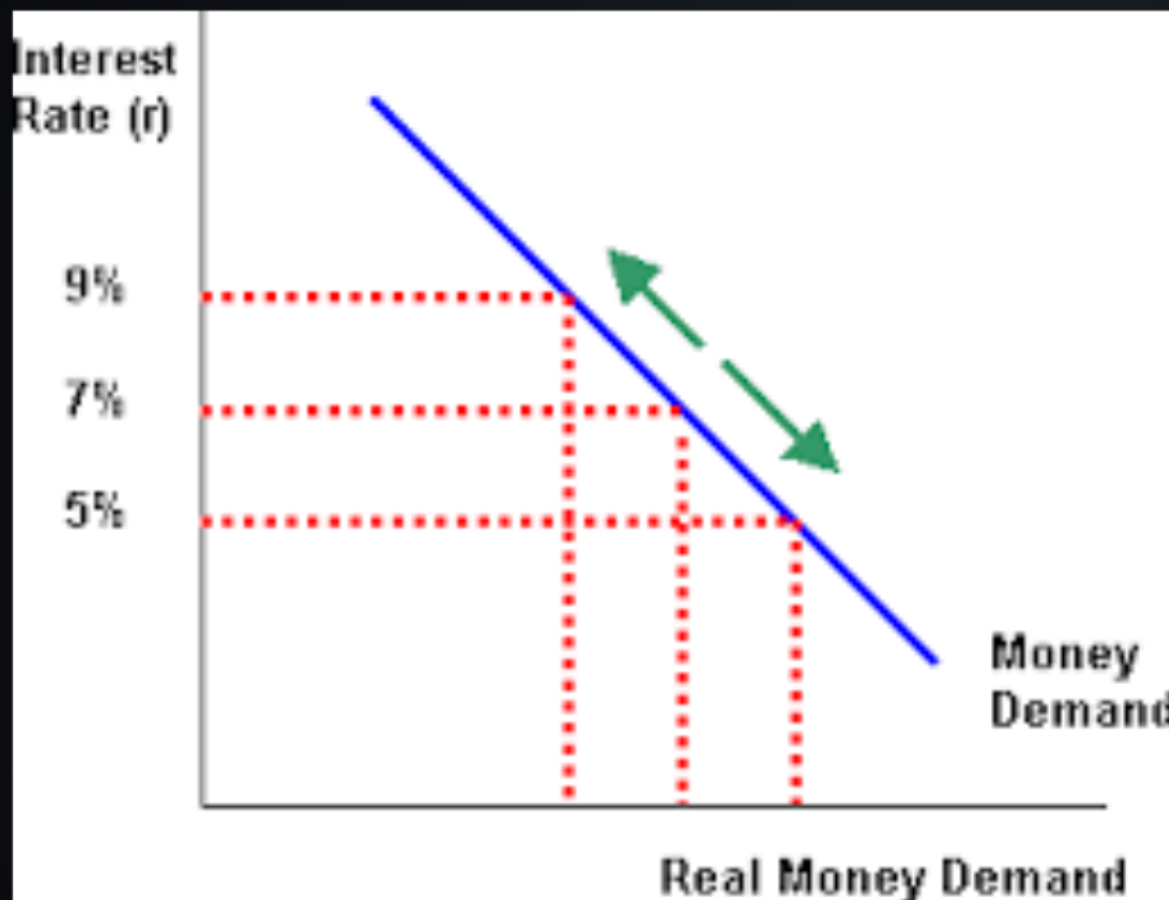
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# The Money Demand Curve

- 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.





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



# 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%.