

4.5 The Money Market

Name: _____ Class: _____ Date: _____

Total: 8 marks

Objective

Build the skills to answer exam questions on **the money market**.

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

1 Worked examples

Study these first. Each one shows the method for a question type used later.

■ 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**.

■ Money supply

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

■ Equilibrium

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

2 Practice

2.1 State why the demand for money slopes downward. [1]

2.2 State the shape of the money-supply curve, and why. [1]

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

supply.

[1]

3 Exam-style questions

3.1 The money-supply curve is

[1]

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

3.2 An increase in the money supply lowers the

[1]

- **A** price level directly
 - **B** nominal interest rate
 - **C** real GDP directly
 - **D** reserve ratio
-

3.3 The central bank increases the money supply.

(a) State the effect on the nominal interest rate.

[1]

(b) State the effect on investment spending.

[1]

(c) State the effect on aggregate demand.

[1]

4 Go further

- work through the **4.5 The Money Market** lesson on the **Learn** page;
- read the **Financial Sector** section of the AP Macroeconomics handout on the **Know** page.

Solutions

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

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

2.3 it falls.

3.1 C.

3.2 B.

3.3 (a) it falls. (b) investment rises. (c) AD rises.