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Paper- I
Topic : The Demand for Money
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The Demand for Money.

The study of the equilibrium of the money market is essential to analyse the effects of the changes in the stock of money. "Money is an asset of the holding public." And it must have demand for it and supply of it and also have market for it.

The demand for money → arised by the general public

The supply for money → it comes from its producers, the govt. and the banking system.

The stock of money refers to its quantity at a given point of time.

Money is an asset i.e., demanded by the public in order to hold it, whatever the motive for holding it and whatever the length of the time period for which it is held.

Demand for money is the sum of all money demanded by individual members of the public, whether households or firms.

- They Theory of the demand for money is mainly concerned with the following questions:

i) What are the determinants of the public's demand for money and why?

ii). Why does the public demand money ?

• Nominal versus Real Cash Balances :-

→ Nominal cash balances are money of the current purchasing power of a unit of money (say, a rupee). A nominal rupee is nominally always a rupee. It is simply monetary value of a rupee

→ Real cash balances are money of some base-year purchasing power. The purchasing power of a nominal rupee in terms of real goods and services can vary from time to time with changes in the general price level. Then it is said that real value (purchasing power) of a (nominal) rupee has been changing over time.

$$\text{Real cash Balance} = \frac{M}{P}$$

where, M = nominal money
P = price level

→ Monetary Theory

There are two main streams of monetary Theory.

i) The neoclassical

ii). The keynesian.

→ The Neo-classical Theory :

The neo-classical theory of the demand for money was put forward by the Cambridge economists "Marshall" and "Pigou".

In cambridge approach, the following demand for money function was hypothesised :

$$M^d = kY \quad \ldots (i)$$

where, M^d = amount of money demanded

Y = money value of national income

k = constant

Since,

$$Y = Py \quad \ldots (ii)$$

where, P = general price level

y = real national income

therefore,

$$M^d = k.Py \quad \text{(from eq}^n\text{ (i) \& (ii))} \quad \ldots (iii)$$

where, k = cambridge "k"

It gives us the demand for money per rupee of "income per unit time". Since, from eq^n (iii) i.e.

$$K = \frac{M^d}{Y}$$

- K = shows the proportion of money income public likes to hold in the form of money,
- Y = flow of money income per unit of time.
- M^d = stock of money at a point of time.

By : Afora