Question 3

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Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_Y Y - L_i i$.

Note that **L_0 is autonomous money demand**, while other terms are the same as in the lecture slides.

Now suppose that L_0 falls.

a. Give ONE reason why this may happen.
b. Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).

a.) Lo is demand to hold the money.

when bond is high return people want to hold bond instead of money