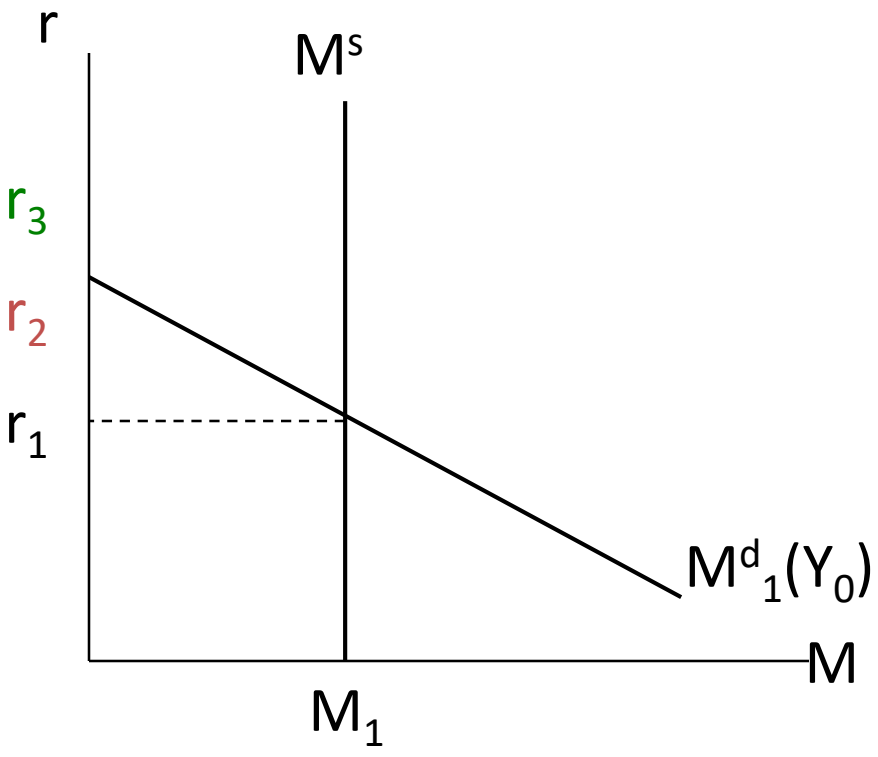
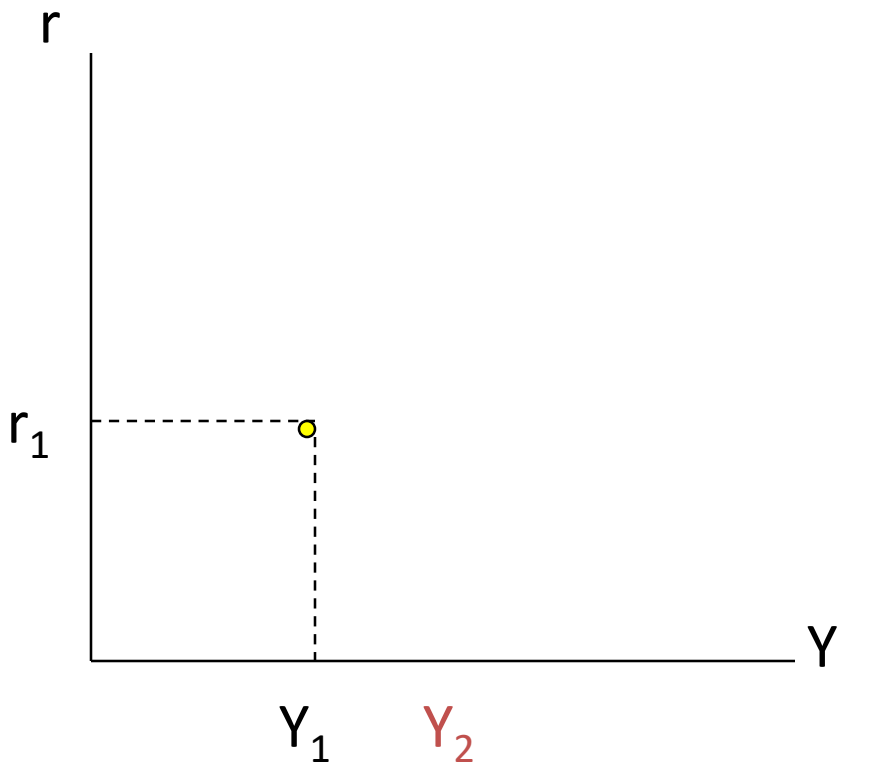
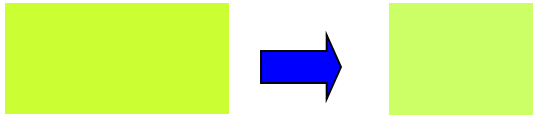
6.2 Money Market and LM Curve

6.2.1 The derivation of LM Curve

Equi^{m} money market: $M^d = M^s$ ⇨ **Find relationship between r and Y**







6.2.2 Factors determining slope of LM curve

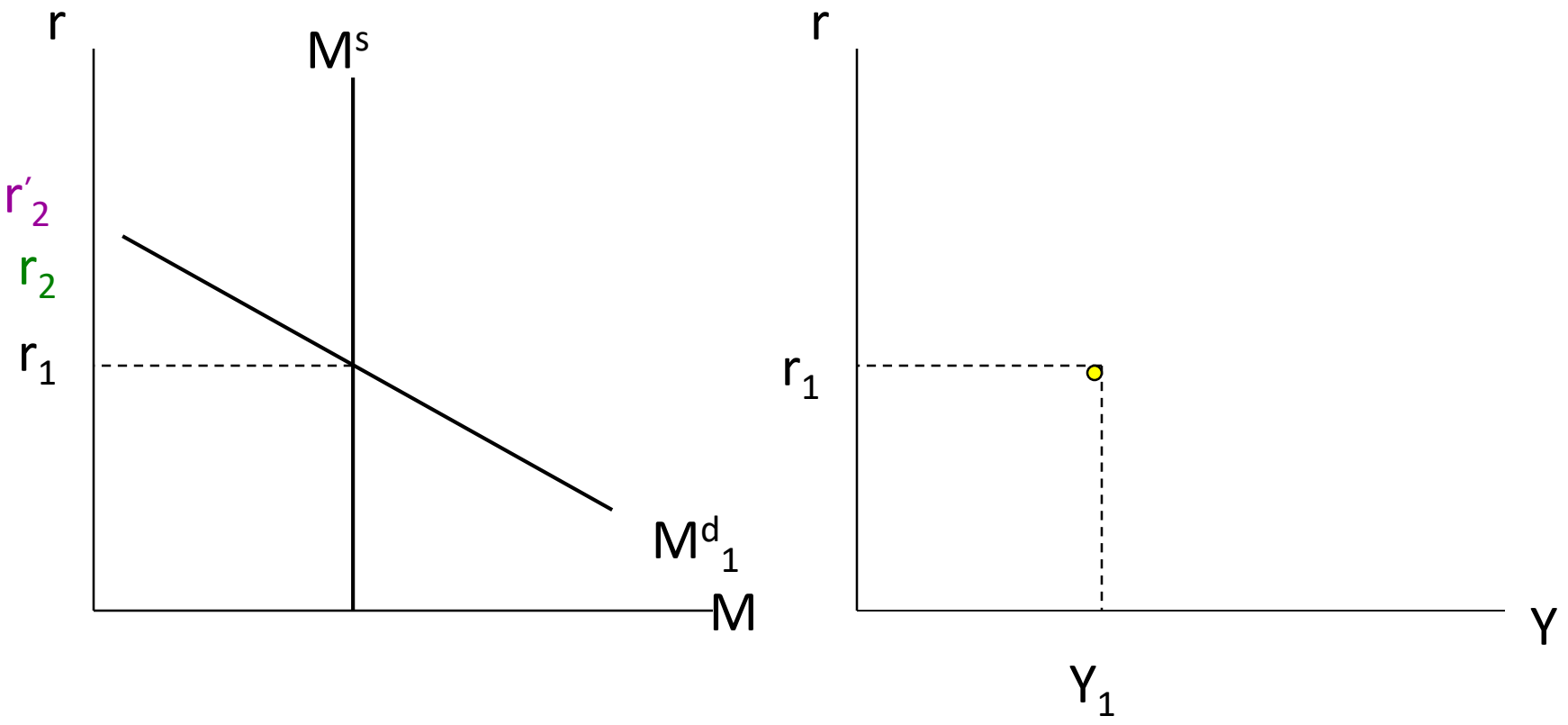
1. The response of people in terms of changes in money demand (M^d) when national income (Y) changes

$$\frac{\Delta M^d}{\Delta Y}$$

2. The response of people in terms of changes in money demand (M^d) when real interest rate (r) changes

$$\frac{\Delta M^d}{\Delta r}$$

Factors determining slope of LM curve : $\frac{\Delta M^d}{\Delta Y}$



Factors determining slope of LM curve : $\frac{\Delta M^d}{\Delta Y}$

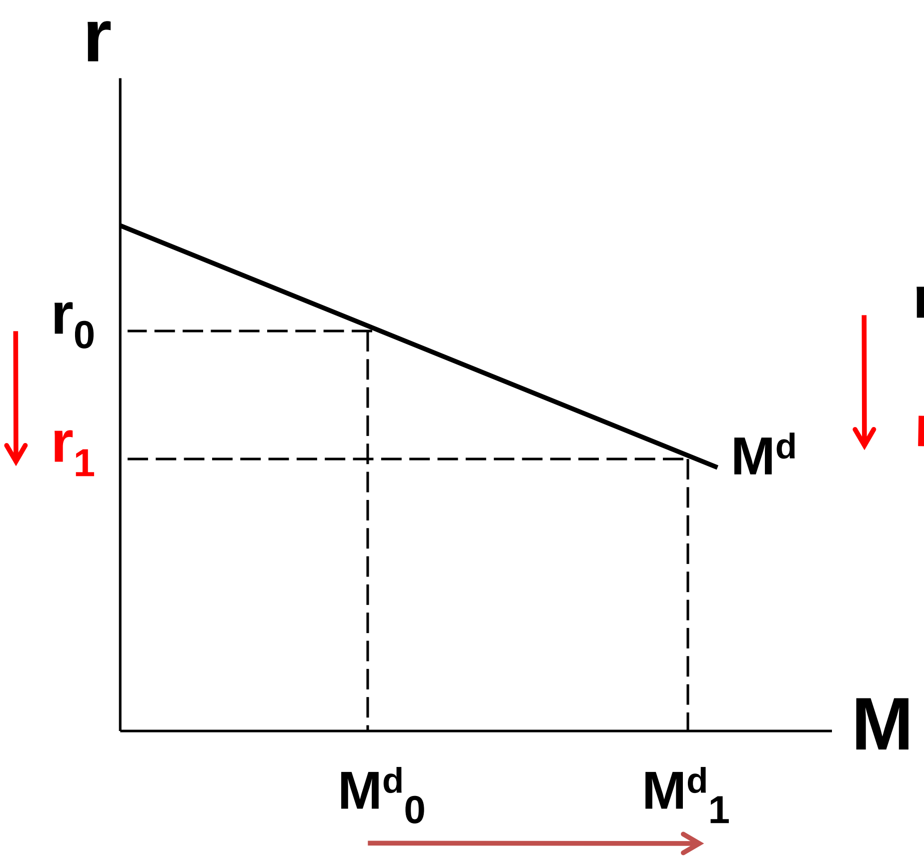
- ∴ If $\frac{\Delta M^d}{\Delta Y}$ high → when Y↑ →

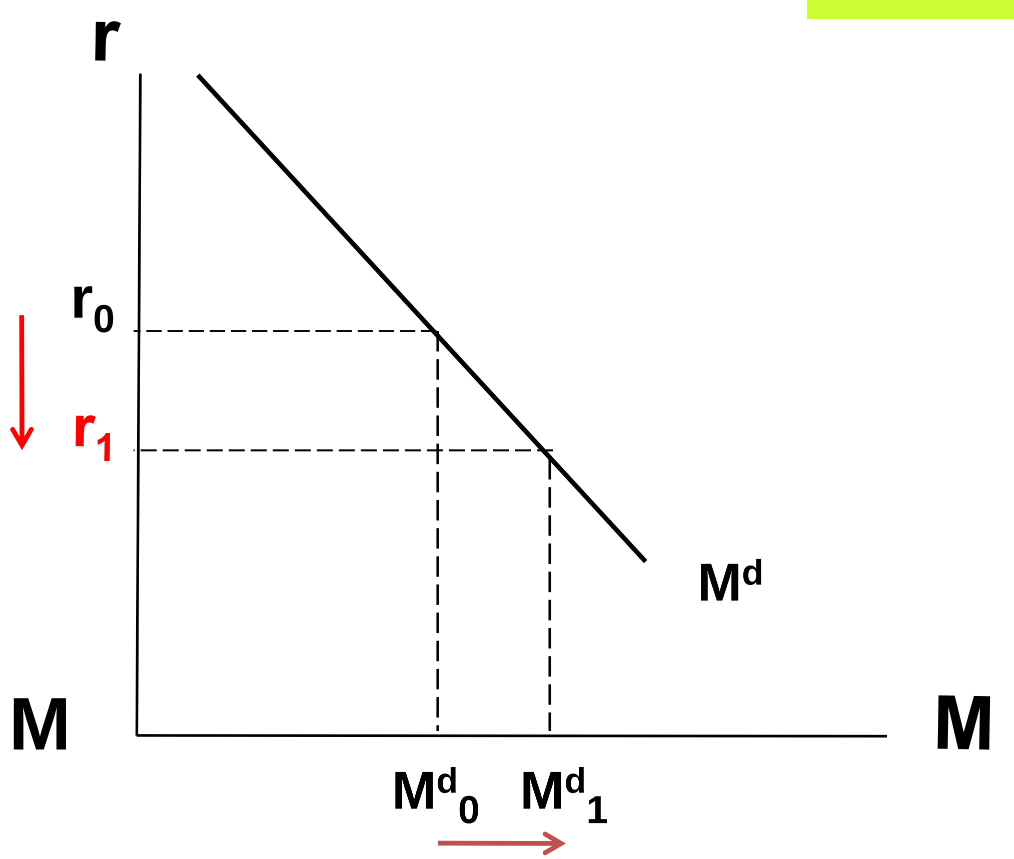
→ →

- ∴ If $\frac{\Delta M^d}{\Delta Y}$ low → when Y↑ →

→ →

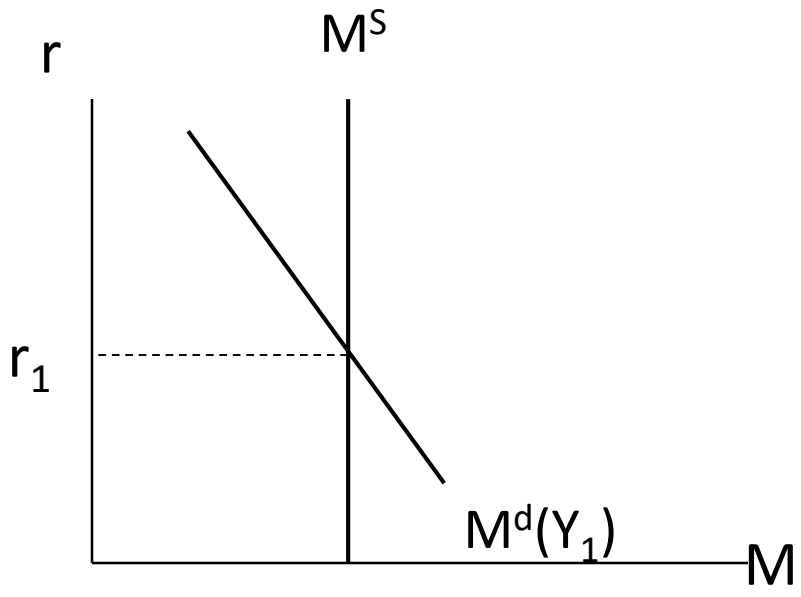
Factors determining slope of LM curve : $\frac{\Delta M^d}{\Delta r}$

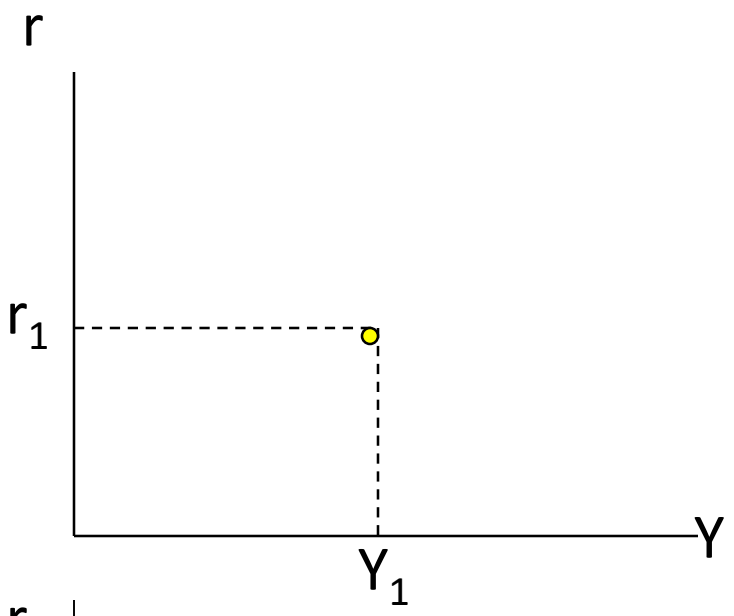


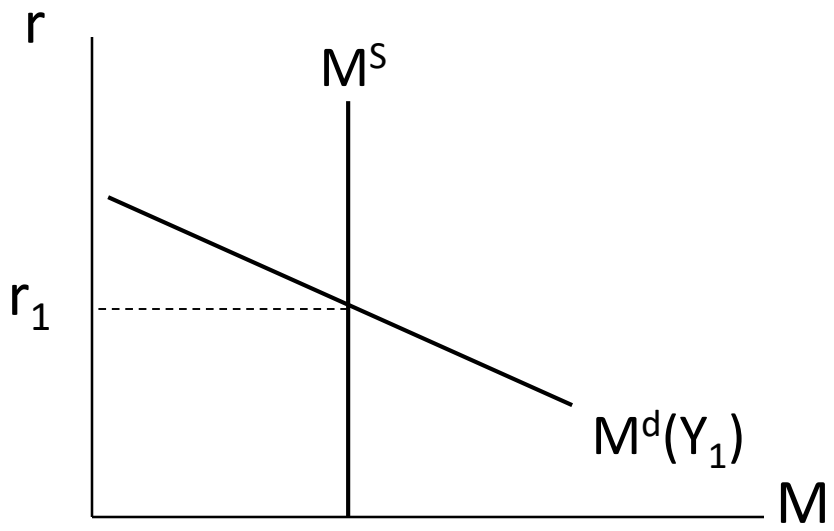


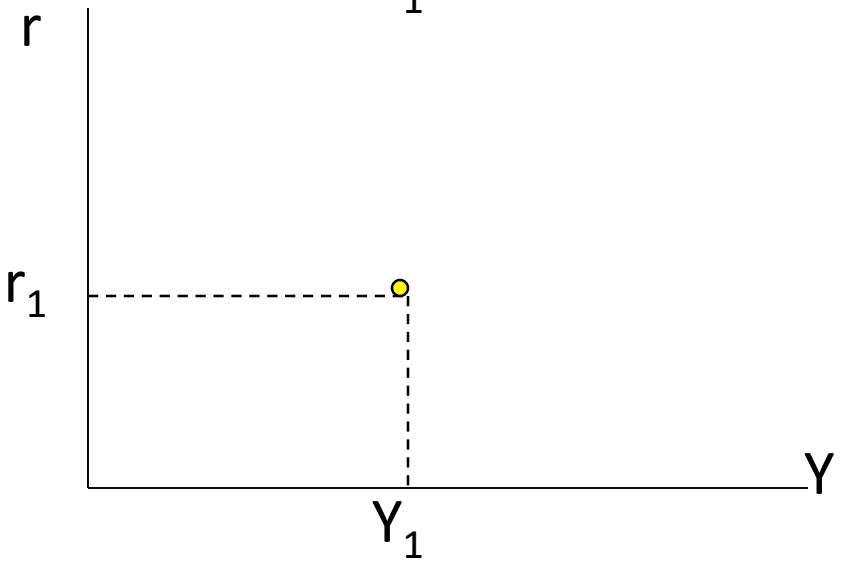
When r↓

Factors determining slope of LM curve : $\frac{\Delta M^d}{\Delta r}$









Factors determining slope of LM curve : $\frac{\Delta M^d}{\Delta r}$

Elasticity of M^d for changes in **r**

$$\varepsilon_{M^d,r} = \frac{\Delta M^d}{\Delta r} \times \frac{r}{M^d}$$

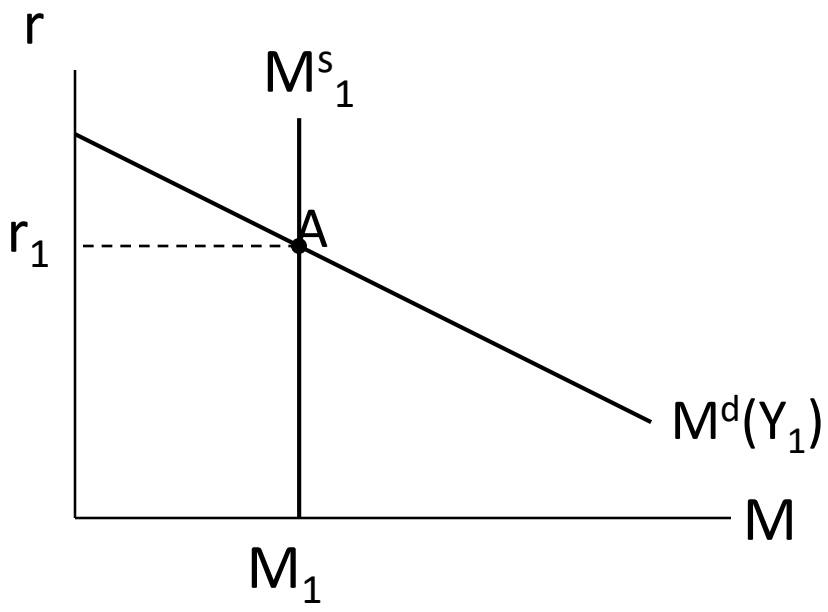
$\varepsilon_{M^d,r}$ low

$\varepsilon_{M^d,r}$ high

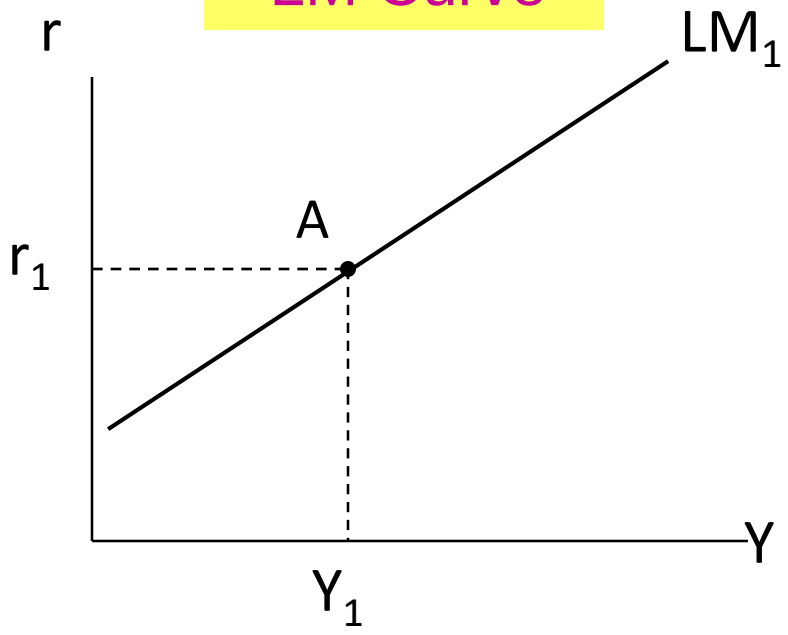
6.2.3 Shifts in LM curve

Eg. From changes in M^s

Money Market



LM Curve

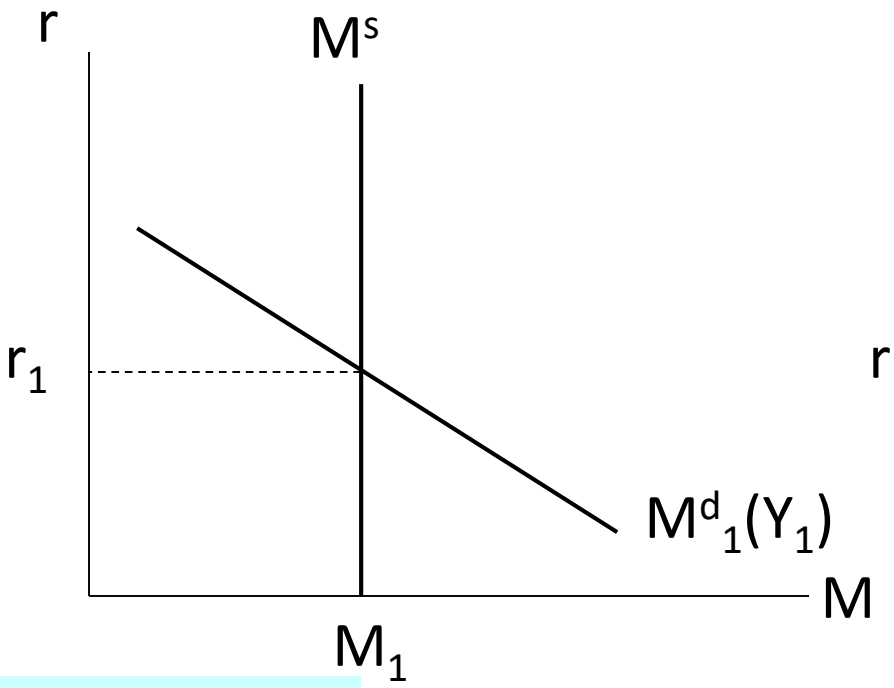


$M^s\uparrow$ ⇒ ⇒

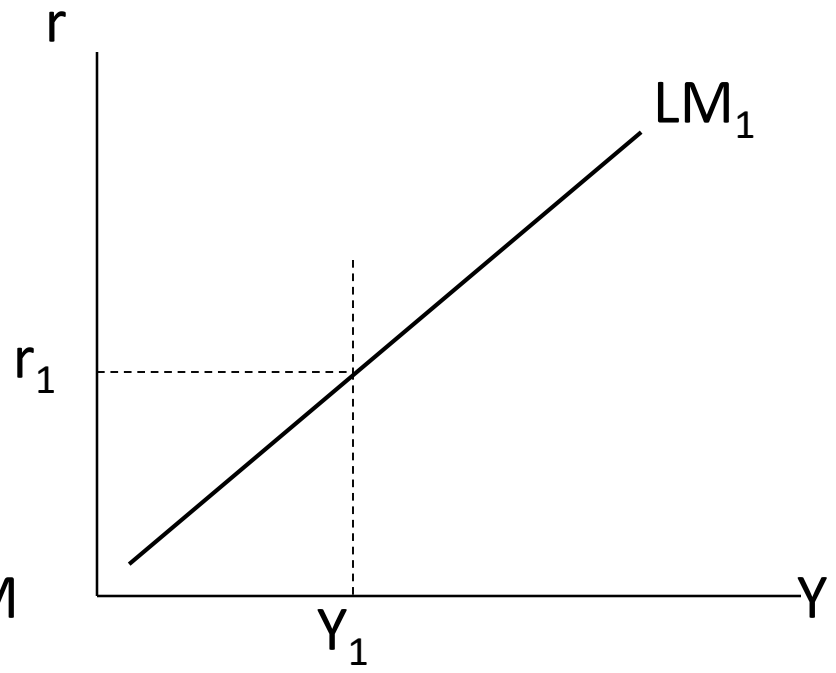
6.2.3 Shifts in LM curve

Eg. From changes in M^d (which is not from changes in Y and r)

Money Market



LM Curve



People change habit to hold more money