Keynes liquidity preference theory

Keynes liquidity preference theory pdf. Keynes liquidity preference theory of demand for money. Keynes liquidity preference theory ppt. Keynes liquidity preference theory slideshare. Keynes liquidity preference theory of interest ppt. Keynes liquidity preference theory indicates that the demand for money is. Keynes liquidity preference theory of interest. Keynes liquidity preference theory indicates that the speculative demand for money is.

Objective learning What is the theory of liquidity preference and how has it been improved? The rest of this book is about monetary theory, a discouraging term. It is not the simplest aspect of money and banking, but it is not terribly taxing, so it is not necessary to scare. We'll take care of it and keep going. And here is a great suggestion: you already know most of the results because it has discussed them in more intuitive terms. In the following chapters, it is simply to provide you with more formal ways of thinking about how the supply of money determines production (Y*) and price level (P*). Intuitively, people want to hold a certain amount of money because it is by definition the most liquid good in the economy. It can be traded for goods at no cost other than the opportunity cost to hold a less liquid income, instead generating a liquid income. When interest rates are low (high), so it is the opportunity cost, so people hold more (less) cash. Similarly, when inflation is low (high), people are more (less) that could contain goods, such as cash, which lose purchasing power. Think about it. Could you be more likely to hold $100 in your pocket if you believed that prices were constant and your bank pays you .00005% interest, or if you thought that the prices of things you buy (such as gasoline and food) I was going on early and your bank pays depositers 20% interest? (Let's hope the first. If the latter, I have derivative bridge titles to sell you.) We begin our theorization with the demand for money, in particular the simple theory of the amount of money, then discuss John Maynard Keynes' Improvement, called the theory of liquidity preferences, and ends with the improvement of the Milton Friedman on Keynes theory, the theory of modern amount of money. John Maynard Keynes (to distinguish it from his father, economist John Neville Keynes) developed the theory of liquidity preference in response to the theory of pre-friedman amount of money, which was simply a loaded hiring identity called the exchange equation: mv = py where m = supply of money V = Speed P = price level Y = output nobody doubted the equation itself, which, as identity (like x = x), is undeniable. But many doubted the way classic quantity theorists used the equation of exchange as a causal statement: increases in the supply of money leads to proportional increases in the price level, although in the long term it was highly predictive. The theory of classical quantity also suffered by assuming that the speed of money, the number of times a year a unit of currency was spent, was constant. Although a good approximation of reality, the theory of classical quantity, which critics derive asThe theory of the amount of money of the "quantity of money", â€ "was barely history. In particular, he could not explain why the speed was pro-cyclic, that is, because it increased during business expansion and decreased during recessions. To find a better theory, Keynes took aStarting point, in fact asking, â € â € œBecause the economic agents hold the money? â € found three reasons: Transactions: Economic agents need money to make payments. As their income increases, so, even make the number and value of such payments, so this part of the money demand is proportional to income. Precautions: Sâ € œ T Capa was a capture phrase of the 1980s, remembered perhaps more famous in successful Forrest Gump film. In the 1930s, Keynes already knew what bad things happened, and that a defense against it was to keep a bit of reserve money around as a precaution. Even it is directly proportional to income, he believes Keynes. Speculations: People will hold more obligations than money when interest rates are high for two reasons. The cost of the opportunity to hold money (which Keynes has assumed zero return) is higher, and expectation is that interest rates will fall, increasing the price of bonds. When interest rates are low, the cost of opportunities to keep money is low, and the expectation is that rates will increase, decreasing the price of bonds. So people take bigest money balances when rates are low. Overall, therefore, the demand for money and interest rates are inversely related. More formally, keynes ideas can be declared as m d / p = f (i = decreases in an increase in interest rates induces people to decrease real money balances for a Given level of income, implying that speed must be higher. Thus, Keynes's vision was higher than the theory of the classical amount of money, because he has shown that the speed is not constant, but rather it is positively linked to interest rates, thus explaining its pro-cyclical nature. (Interest rates increase during expansions and fall during recessions.) Keynes's theory was also fruitful because it led other scholars to process it further. In the early 1950s, for example, a young Will Baumol and James Tobin have shown independently that monetary budgets, detained for transaction purposes (not only speculative), were sensitive to interest rates, even if the return on the money It was zero. This is because people can contain bonds or other titles of interest until they need to make a payment. When interest rates are high, people will deal less money for transaction purposes as much as possible, because it will be worth the time and the difficulty of investing in bonds and then liquidate them when necessary. When the rates are low, on the contrary, people will hold more money for purposes of Because it is not worth the costs of Hassle and brokerage to play with bonds very often. So the demand for money transaction is negatively linked to interest rates. A similar compromise also applies to precautional budgets. The bait of high interest rates compensates for the fear of bad events occurring. When rates are low, better to play safely and hold more pasta. So so The demand for money is also negatively linked to interest rates. And both the demand for transaction and precaution are closely linked to technology: faster, cheaper, and more easily you can exchange bonds and money to one another, more money-like bonds will be lower and lower of cash instruments, Ceteris Paribus. KEY TAKEAWAYS Before Friedman, the theory of quantity of money was a much simpler thing based on the so-called exchange equation â € "Money times equal to the output price times (MV = PY) â €" more Hypothesis that changes in the offer of money causes outgoing changes and prices and that the speed changes so slowly can be treated safely as a constant. Note that the interest rate is not at all considered in this so-called naive version. Keynes and its followers knew that interest rates were important for the demand for money and that speed was not a constant, so they created a theory in which economic actors ask for money to engage in transactions (buy and sell goods), As a precaution against unexpected negative shocks, and as a speculation. Due to the first two reasons, the real balances increased directly with the output. Due to the speculative motive, the real money balances and interest rates are inversely related. When interest rates are high, so it is the cost of opportunities to keep money. Throw the expectation that rates could fall, causing bond prices to rise, and people are induced to hold less money and more obligations. When interest rates are low, by contrast, people expect to get up, which will hurt titles prices. Furthermore, the cost of the opportunity to keep the money to carry out transactions or as a precaution against shocks is low when interest rates are low, so people will deal more money and less obligations when interest rates are low. Liquidity's theory of preferences is a theory that suggests that investors require higher interest rates or additional premiums for medium or long-term maturations and investments. According to this theory, the risks increase with maturity, and in this situation, investors should aim at higher interest rates. As short-term investments are more liquid than medium or long term investments. Just put, interest rates directly indicate the money price. Therefore, other things that remain constant demand and supply of money determine the interest rate. Furthermore, there is an old man in the financial and investment world that â € œA bird in his hand is worth two in the bush. And this fully confirms and justifies the preference for liquidity and an increase in premiums or interest rates as it increases Understanding Liquidity Preferences Theory Liquidity Preferences Theory of Liquidity Preferences was developed by John Maynard Keynes in 1936. And this theory gives immense importance to the liquidity factor of investments. According to this theory, short-term investments give a lower interest rate because they provide liquidity to investors. In addition, medium and long-term investment leads tointerest rates due to their illiquid nature. Short-term investments are either up or within a year of deposit by providing liquidity, unlike medium and long-term investments that mature after 3-10 years and are of an illiquid nature. According to John Maynard Keynes, demand and currency supply determine interest rates. Individuals prefer to hold liquidity in their hands rather than invest preferring liquidity. Thus, according to Keynes, interest rates are a reward for lack of liquidity in their hands, and consideration goes hand in hand with the ideology according to which money is the most liquid activity. Demand for Money (Motives) Liquidity Preference The theory measures liquidity in relation to demand for money or other liquid instruments. And according to Keynes, there are three main reasons (motives) for the demand for money. These reasons are as follows: Reason for transactionsIt is a fundamental reason for the individual's request for money. Here, in order to meet all daily needs, the individual needs money with a transaction motive. For transaction reasons, the individual requires money to buy food and maintain the standard of living. Moreover, an increase in expenditure motivated by a transaction entails an increase in living standards. Therefore, in order to maintain the standard of living, individuals need sufficient money. Most people with higher earning capacity require more money to meet daily needs According to John Maynard Keynes, transaction-based demand is not elastic compared to interest and elastic rates than the income level. As a result, the Transaction Motive is a function of income levels and is expressed as follows: «T = f (Y) Where,T = Request via TransactionY Reason = Reddied Level In a few words, the request for cash with a transaction Reason is to pay current expenses. Precautionary Reason According to John Maynard Keynes, this is the second reason for the demand for money. Individuals ask for precautionary money to protect themselves from a uncertain future. Because the future is uncertain and sudden natural or human-induced disasters may occur. In this situation, in order to protect itself, individuals ask for money with precautionary intentions. And the precautionary money is known as 'inactive held. » These uncertain situations require cash outflow and so individuals require money for the same. According to John Maynard Keynes, the demand for precaution is anelastic with respect to the interest rate and elastic with respect to income levels, such as the motivation of transactions. Consequently, the precautionary reason is a function of income levels and the expression of the income is as follows: P = f (Y) Where,P = Question byPrecautionaryY = Income levelIn a nutshell, asking for cash for precautionary reasons is to protect yourself from uncertain future conditions.Speculative reasonA speculative reason is the third reason why the demand for money. Based on this reason, individuals ask for money by taking in fluctuations in interest rates or bond prices. If interest rates are lower or bond prices are lower, there is a high demand for money with speculative reasons and vice versa. If interest rates are lower, these individuals hold / hoard their money and invest later when interest rates are higher. Accordingly, according to the speculative demand for money, there is a reverse relationship between interest rates and demand for money, and the expression of speculative motive is as follows: –S = f (R)Where,S = Demand through Speculative MotiveR = Interest RateSemplicably put, the demand for money with a speculative motive is to generate profits by changing the investment scenario and the value of the tools. The above three reasons are therefore the reasons for liquid funds held by individuals. Total application The aggregate demand for money or the liquidity preference function would be the sum of all three transactions, precautions and speculatives). TD = T + P + STD = f (Y) + f (Y) = f (R)Total Demand = f (Y, R) Where TD is the Total Demand, which is the function of Income (Y) and Interest Rate (R). Money supply According to John Maynard Keynes, the supply of money is largely fixed and determined by the central bank of the country. Therefore, according to the theory of liquidity preference, the supply is perfectly inelastic and graphically represents a straight vertical line. Determination of interest rate The interest rate is determined at the point where the demand for money is equal to the provision of money. And, in the chart of the determination of the interest rate, the TD curve is lowering down from left to right. This is due to the opposite link between the demand for money and the interest rate. While the power curve (SP) is perfectly inelastic and represents a straight vertical line. We understand this with a graphic representation:- Interpretation As shown in the above figure, the X axis measures the amount of money and the Y axis the interest rate. In the figure, TD is the demand curve of money and SP is the supply curve of money. And the point where the demand for money is equivalent to the offer of money is denoted by E. At point E, both curves intersect and determine the interest rate R, and the interest rate R is the interest rate of balance. At point E1, the offer of money is higher than the demand for money, and so individuals buy more titles. In such situations, the interest rate begins to fall back to point-R (balance level). Similarly, at point E2, the demand for money is higher than the supply of money, and therefore individuals will begin to sell the securities. As a result, the interest rate will increase to balance level R.If we look at the figure above, there is a liquidity trap, and the range between R-Min and R-Max islike a liquidity trap, so that the interest rate only floats under this trap. Limitations of liquidity Preferences Theory One of the biggest limits of liquidity preferenceis that it is assumed that the employment rate is constant. In fact, the employment rate is not constant and is constantly changing. The second criticism is that this theory assumes a certain level of income. The third criticism is that this theory argues that it is money or an investment in bonds. In today's scenario, many people have money at their disposal for liquidity and bond investment purposes. This theory completely ignores the scenario of receiving interest benefits for some funds and receiving liquidity benefits for the remaining funds. The fourth criticism is that there are different interest rates in different markets at the same time, which the theory of liquidity preferences completely ignores. According to experts, the preference for liquidity is not the only criterion for interest rates. This theory does not take into account many real elements. This ignorance is the fifth criticism. Savings made by individuals are not considered under this theory. These criticisms are by nature not exhaustive. Conclusion of the theory of liquidity preferences Despite many criticisms of the theory of liquidity preferences, it is useful to identify the effect of the demand and supply of money on interest rates. It shows the relationship between the motivations of people with income and interest rates. It also states that monetary policy is not effective in the economy due to a liquidity trap during the economic depression. At the same time, however, we need to understand and evaluate that liquidity is not the only factor driving the supply of money or interest rates. There are so many other factors to consider before making a decision. Share The Knowledge if you like