Welcome

MONETARY ECONOMICS

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TOPIC : CLASSICAL THEORY - LOANABLE FUNDS THEORY

CONTENTS :

MONEY :

A medium of exchange that is centralized ,generally accepted , recognized, and facilitates transactions of goods and services ,is known as money.

"MONEY IS WHAT MONEY DOES"

-WALKER

INTEREST RATE :

It is the rate of return on capital. Interest is the price paid for borrowed funds. It is cost to the borrower and return to the lender.

MONEY SUPPLY :

- It refers to the amount of money which is in circulation in an economy at given time.

MONEY DEMAND :

- The demand for money is the desired holding of financial assets in the form of money.

CLASSICAL THEORY :

- According to the classical theory , rate of interest is determined by the supply and demand of capital. The supply of capital is governed by the time preference and the demand for capital by the expected productivity of capital.

DIAGRAM :

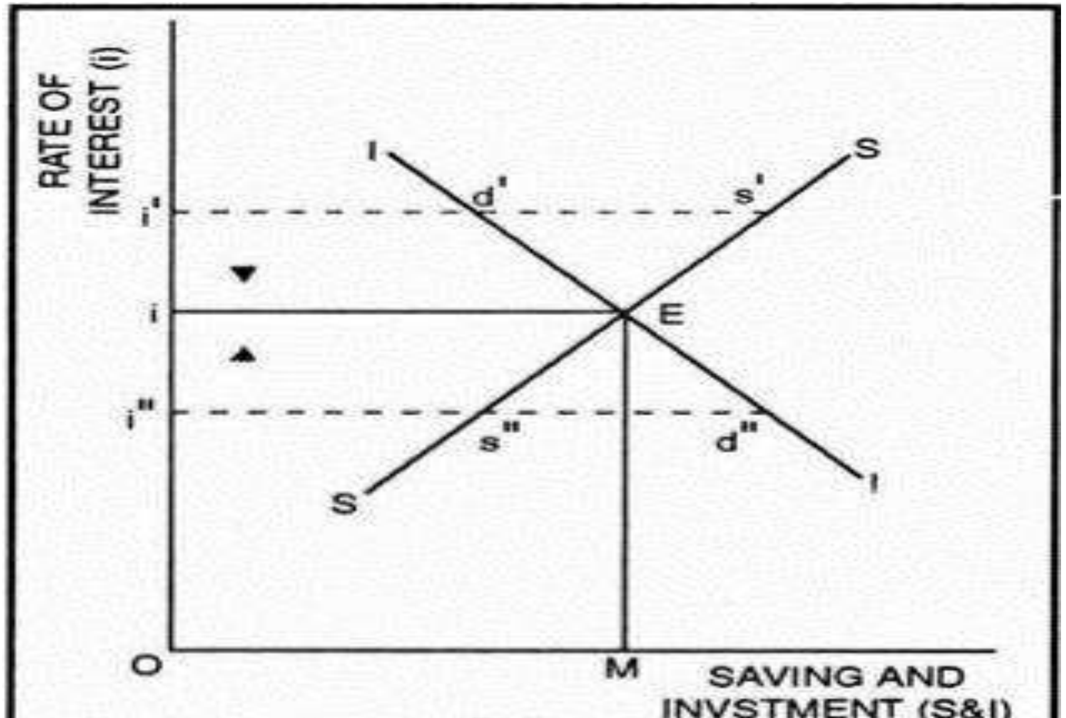


Fig. 1.

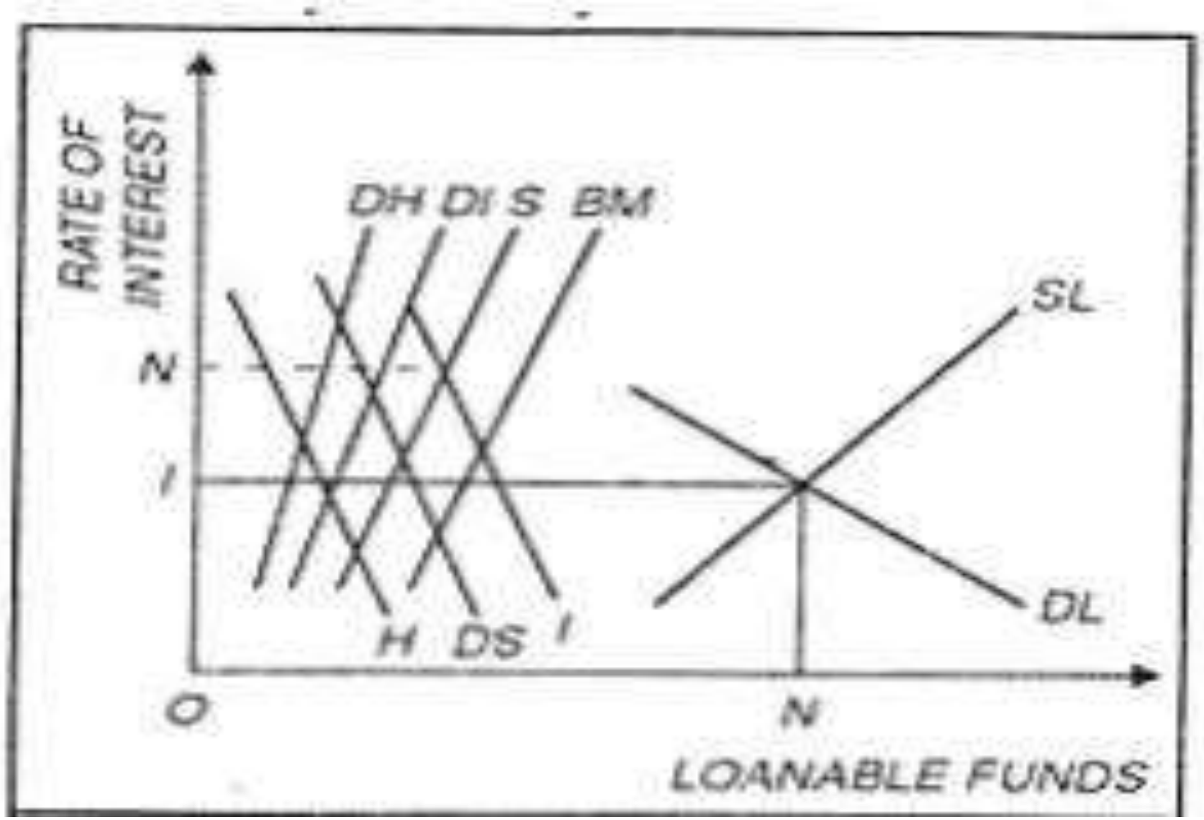
CRITICISMS :

- Income not constant but variable.
- Savings- Investment schedules not independent.
- Neglects the effect of investment on income
- Indeterminate theory.
- No automatic equality.
- Neglects Monetary Factors.
- Unrealistic assumption of full employment.

LOANABLE FUNDS THEORY :

- According to this theory , the rate of interest is the price of credit which is determined by the demand and supply for loanable funds.
- In the words of Prof. Lerner: “It is the price which equates the supply of credit , or saving plus the net increase in the amount of money in a period , to the demand for credit , or investment plus net hoarding in the period”.

DIAGRAM :



CRITICISMS :

- Equilibrium rate reflects unstable equilibrium.
- Indeterminate theory
- Cash balances not elastic.
- Savings not interest elastic.
- Not correct to combine real and monetary factors.

Thank You

Segmented Markets Theory

&

Expectations Theory

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SEGMENTED MARKETS THEORY

Introduction to
SEGMENTED MARKET THEORY

Segmented market theory says that, The SHORT TERM and LONG TERM bond markets are treated as separate or " SEGMENTED. " Since investors don't move easily between The two terms, The short term rate hikes don't affect long term rated As much.

ASSUMPTIONS of segmented market theory

INVESTORS HAVE FIXED PREFERENCES : Investors prefer Specific maturities (short term or long term) based on their needs They are not interested in switching (short term or long term) even If one offers a higher return.

NO SUBSTITUTION : Investors do not substitute between short term And long term bonds because they have different goals – short term For quick returns and long term for future planning. They stay in Their preferred market segment.

EXAMPLE FOR SEGMENTED MARKET

Imagine the central bank decides to raise short term interest rates to control inflation… it makes borrowing expensive for short term.

SHORT TERM INVESTORS : They experience an immediate increase in interest rate making borrowing costlier. This can lead to higher Expenses and reduced investment appeal.

LONG TERM INVESTORS : they stick to long term bonds and they Have different goals such as retirement planning or projects so the Short term fluctuation are doesn't directly impact their long term Strategy.

SEGMENTATION

Investors in SHORT TERM BONDS don't easily switch to LONG TERM BONDS, even if long term bonds have higher returns. Similarly, investors in LONG TERM BONDS don't easily switch To SHORT TERM BONDS, even if short term increases. This Is what SEGMENTED MARKET theory is about – each group of investors stays in its own 'SEGMENT' based on its needs.

CRITICISM of Segmented Market Theory

INVESTORS ARE MORE FLEXIBLE : The theory assumes that Investors only stick to either short term or long term bonds, But in reality, they might switch between the two if they See better returns in one of them.

MARKETS ARE CONNECTED : The theory treats short term And long term bond markets as completely separate. However in Real life, changes in one market Often affect the other, meaning they are more connected.

EXPECTATIONS THEORY

Introduction to
EXPECTATIONS THEORY

"Expectations theory refers to how people's beliefs or Expectations about the future (like future inflation, interest Rates, or economic conditions) affect their decisions today".

EXAMPLE : If you think PRICES are going to go up next month, We might buy things now to save money

It's all about how our beliefs about the future shape what We do right now

Assumption of Expectation theory

PEOPLE USE INFORMATION : People make predictions About the future based on all the information they have.

PAST INFLUENCES FUTURE : If using adaptive expectations, people base future predictions on past trends.

TYPES of Expectation theory

ADAPTIVE EXPECTATIONS

based on past experiences

RATIONAL EXPECTATIONS

Forward – looking, based on

All available information

EXAMPLE of adaptive expectations

Imagine you guys go to the market to buy vegetables. For The past few months, the price of tomatoes has been increasing by ₹2 every month. Based on this pattern, you guys except the Price to rise by ₹2 again next month, So you guys plan to buy More tomatoes now before the price goes up.

In ADAPTIVE EXPECTATIONS People predict future Outcomes based on what they've seen happen in the past.

EXAMPLE of rational expectations

Suppose you know the government is planning to increase Takes next year to fund a new project. Based on this Information, you expect prices to rise due to the higher taxes. So you decide to save more money now and delay big Purchases until after the tax increase is implemented.

In rational expectations people use all available information (like government announcements or economic reports) to Make the best predictions about the future…

CRITICISM of Expectation theory

A Simple criticism of expectation theory is that it assumes People always make decision based on their predictions of the future. In reality, people can be influenced by emotion or Incomplete information, which can lead to less accurate Expectations and decisions.

THANK YOU……