$$\frac{Md}{P} = f(W, r, w, T)$$

Where $\frac{Md}{P}$ = real demand for money;
W = total wealth;
r = expected rate of return on various forms of wealth;
w = ratio of human wealth to non-human wealth; and
T = Society's tastes and preferences.

Demand for money is directly related with total wealth as long as wealth holders regard money as a normal good. Since rates of return on bonds and equities represent the opportunity cost of holding money, demand for money is inversely related to the expected rates of return on wealth.
The higher the ratio of human to non-human wealth the greater will be the demand for money in order to compensate for limited the limited marketability of human wealth. Demand for money also depends on various factors that influence wealth holders' tastes and preferences for money.

Friedman defines income in this model as measured by permanent income. He also assumes that W & T are constant in the short run. Therefore, the aggregate money demand becomes:

$$\frac{Md}{P} = f(YP, r)$$

This is the modern quantity theory of demand for money equation.

Money Supply

Money is defined in two ways: narrowly and broadly.

The narrow definition for money includes coins, currency, demand deposits and other checkable deposits. The total of coins, currency, bank deposits and other checkable deposits is what we call money supply in the narrow sense. This is also called M1.

Coins:
Are a small proportion of the total quantity of money in an economy. They come in small denominations. They are made of metal and normally the value of metal in them is less than the face value of the coin.

Currency
This is paper money e.g. 50/= and 100/= bills. Currency constitutes the second and far larger share of the total money supply than coins. The central bank of Kenya issues all the currency just as it does the coins. Initially, there used to be gold of equivalent value to the amount of currency issued to back it and give it value. Currently, however, all the money is not backed by gold. Its value is derived from its acceptability by people.

Bank Deposits

These are bank deposits subject to payment on demand. They are much larger than coins and currency. They are also called checking accounts. These deposits are considered to be money because they can be as easily used in transactions as cash, by simply issuing a check. They are as much as money in storing value, as a medium of exchange and as a standard of value.

Other checkable deposits

These include negotiable order of withdrawal (NOW) accounts and other accounts that are very close to being demand deposits. NOW accounts are interest-bearing checking accounts at banks, savings societies and other financial institutions. Money supply is broadly defined as narrow money plus savings and small time deposits, money market mutual fund balances and money market deposit accounts. This money supply broadly defined is also called M2.

The reason why time and savings deposits were excluded from the narrow definition of money is that they are not readily withdrawable and so can't perform effectively the role of being medium of exchange. However, since they perform the other functions of money and can actually be withdrawn and used for transaction (though not readily), they have been included in M2.

NB

Note that there is no clear dividing line between money and non-money, since many assets have some characteristics of money. For instance, it is easy to convert government bonds into money, but they are not included in money because their prices fluctuate with interest rates and so they are not a good store of value. Assets that are easy to convert into cash are called rear-money. There is disagreement, however, among economists as to what is to be considered rear-money and what not to be considered rear-money.

The concept of velocity of money

Velocity of circulation of money is the rate at which money stock is used to make transactions for final goods and services.

This was put forward by Irving fisher, in his version of the quantity theory of money

Fisher summarized the quantity theory of money in the following equation:

$$MV \equiv PT$$

Where: M = nominal stock of money in the economy

V = the transactions velocity of circulation of money

P = the general price level of all transactions

T = the number of transactions that take place during the time period

Both MV and PT measure the total value of transactions during the time period hence are always identical.

For example if we suppose that in a given economy the number of transactions (T) = 100 and the average price (P) is 10/=, then PT = 1000/=. If the stock of money is 100/=, then the number of times it changes hands (V) = 10.

Therefore given any three of the components of the identity MV = PT, it is possible to compute the value of the remaining component.

The Open Economy

The foreign sector is captured in the analysis of equilibrium through the balance of payments (BOP). Balance of payments is a summary statement of the monetary value of the flow of

- This is the level of unemployment that exists when the economy is at full employment, producing its potential output.

4. Frictional Unemployment

- This is caused by the time lag involved in redeployment of labor. This land of unemployment is caused by mobility problems in the labor market, which result in friction in the labor market. This friction is either due to communication problems or mismatch between job opportunities and job seekers.

5. Seasonal Unemployment

- This arises due to the seasonal nature of some productive activities e.g. production in the agricultural sector.

6. Structural Unemployment

- Results either from change in demand occasioned by change in consumer tastes and preferences or from technological change.

7. Cyclical Unemployment

- Is caused by business cycles or swings in the economy e.g. depression and boom

8. Under-employment

- It occurs when people are working less than they would like to work. Or when people are in jobs that totally underutilize their skills and competence.

9. Disguised Unemployment

- Individuals do not want to do certain jobs because of their qualifications

10. The unemployment of Prematurely Retired

- This occurs when people are retrenched before they attain retirement age.

Causes of Unemployment

1. Lack of cooperating factors
2. rapid population growth
3. Inappropriate technology
4. Relative factor price distortions
5. The education system
6. seasonal nature of production
7. Rural urban migration

Policies for curing Unemployment

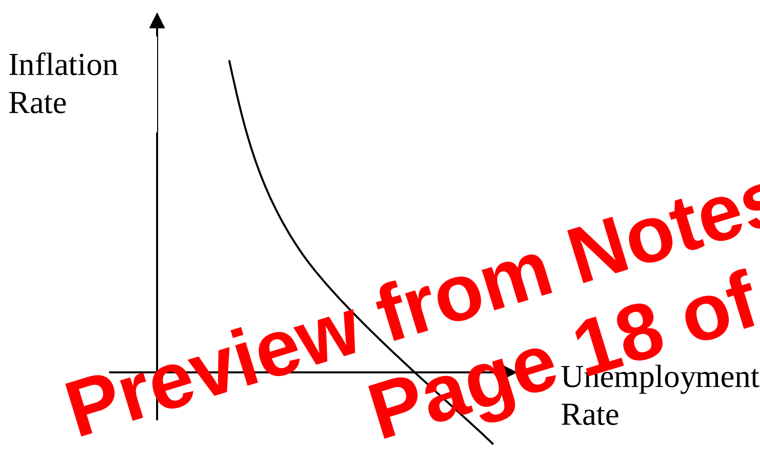
1. Wage subsidies. Subsidizing wages means lowering wages hence firms will employ more people.

- Government exhortations to firms to avoid unjustified price rises and to unions to avoid unjustified wage claims
- The setting up of a prices and incomes board to examine proposed price increases and to contribute to collective bargaining between employers and unions.
- Bringing together of employers' and unions' organizations in an attempt to obtain some voluntary agreement from both parties to keep prices and incomes down.
- The impositions of legislation to regulate or even freeze wages and prices.

Indexation

This policy is sometimes called index linking. It works by linking economic variables for example wages, salaries, and interest payments to an index of inflation like the consumer price index. This means that as the price index rises, wages, salaries and interest payment rises simultaneously.

The Philips Curve



The Philips curve postulates that in general, the rate of inflation fall as unemployment rises and vice-versa. The curve therefore shows that there is a trade-off between inflation and unemployment meaning that a lower rate of inflation could be achieved but only at the cost of higher rate of unemployment. The Philips curve thus validates the Keynesian argument that in order to achieve full employment some level of inflation is unavoidable.

INTERNATIONAL TRADE

It is the exchange of goods and services between one country and another. International Trade can be in goods, termed visible or in services; termed invisibles e.g. trade in services such as tourism, shipping and insurance.

Reasons for the Development of International Trade

a. Some goods cannot be produced by the country at all. The country may simply not possess the raw materials that it requires; thus it has to buy them from other