

Lecture 11

Money and Banking, Econ 345

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Summary so far

- So far - only one way to acquire consumption at a later time - by holding fiat money
- We start to study demand for money in presence of other assets
- Later: study banking - intermediation of assets into money and back, and central banking
- Today - capital, special assets because it affects the level of output

Equilibrium without money

- Remember that young want to use some of their endowment in order to consume when they become old
- Young : convert k_t units of their endowment into capital in period t , the budget constraint is

$$c_1 + k_t \leq y$$

- Old: consume goods produced by the capital - xk_t , the budget constraint is:

$$c_2 \leq xk_t$$

- Lifetime budget constraint

$$c_1 + \frac{c_2}{x} \leq y$$

Equilibrium with capital

Budget constraint: $c_1 + c_2/x = y$

Return on capital x determines demand for capital and hence the equilibrium consumption bundle B

