

Household's Utility Function

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Utility function:

- c : consumption of services
 - m/p : real money balances
 - m : nominal money balance
 - p : price level
- real wealth
- wealth in the utility function

Justification for (real) wealth in the utility

- Introspection : people enjoy accumulating wealth, in particular b/c wealth offers social status / power
- Neuroscientific evidence that wealth itself provides utility, independent of consumption it can buy [Camerer, Loewenstein, Prelec, 2005]

Household's utility function

$$u\left(c, \frac{m}{p}\right) = \frac{\alpha}{1+\alpha} \cdot c^{\frac{\alpha-1}{\alpha}} + \frac{1}{1+\alpha} \left(\frac{m}{p}\right)^{\frac{\alpha-1}{\alpha}}$$

$\alpha > 0$: taste for services relative to wealth
high α → services are more valued

$\alpha > 1$: elasticity of substitution b/w consumption & real money balances