

Final Exam Quiz

THOSE WHO COPY YOUR FRIENDS OR LET YOUR FRIENDS COPY YOU WILL BE AWARDED ZERO.

ปล ผมจดไว้แล้วนะครับว่าตอนมิตเทอมใครลอกของใคร ครั้งนี้ขอเตือนเลยว่าผมไม่ยอมแล้วนะครับ

ผมต้องลงโทษ ไม่งั้นต่อไปคงไม่มีใครอยากซื้อสตั๊ด

Submission Guide: You can upload up to 3 files on Moodle. If the whole file is too large, you should break it down and upload 3 files, each containing 1 question.

Question 1

Draw 3 diagrams (Keynesian Cross, Money Market, IS-LM) to **show and briefly explain** the followings:

- The crowding-out effect when the government increases its spending
- Another policy that can be used to avoid the crowding-out effect

Question 2

Draw the IS-LM diagram. **Pick ANY point on either the IS curve or the LM curve** (NOT the general equilibrium point). ย้ำว่าเลือกจุดไหนก็ได้ที่อยู่บนเส้น IS หรือ LM ที่ไม่ใช่จุดตัดตรงกลางของสองกราฟ

Use the diagram that you draw to briefly explain how the two markets at **your current point** will adjust towards the general equilibrium.

Question 3

Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_Y Y - L_i i$.

Note that L_0 is **autonomous money demand**, while other terms are the same as in the lecture slides.

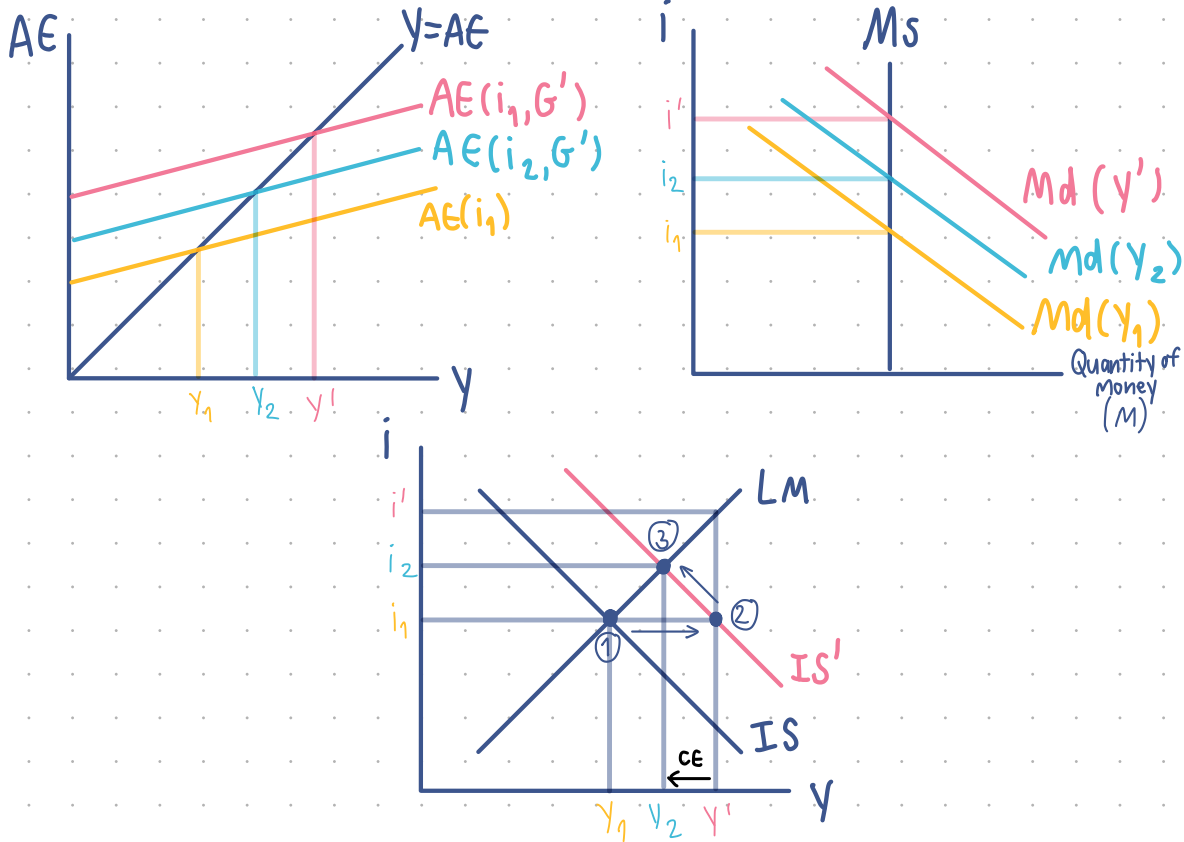
Now suppose that L_0 falls.

- Give ONE reason why this may happen.
- Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).

Draw 3 diagrams (Keynesian Cross, Money Market, IS-LM) to show and briefly explain the followings:

- a. The crowding-out effect when the government increases its spending
- b. Another policy that can be used to avoid the crowding-out effect

(A) Expansionary $\rightarrow G \uparrow$



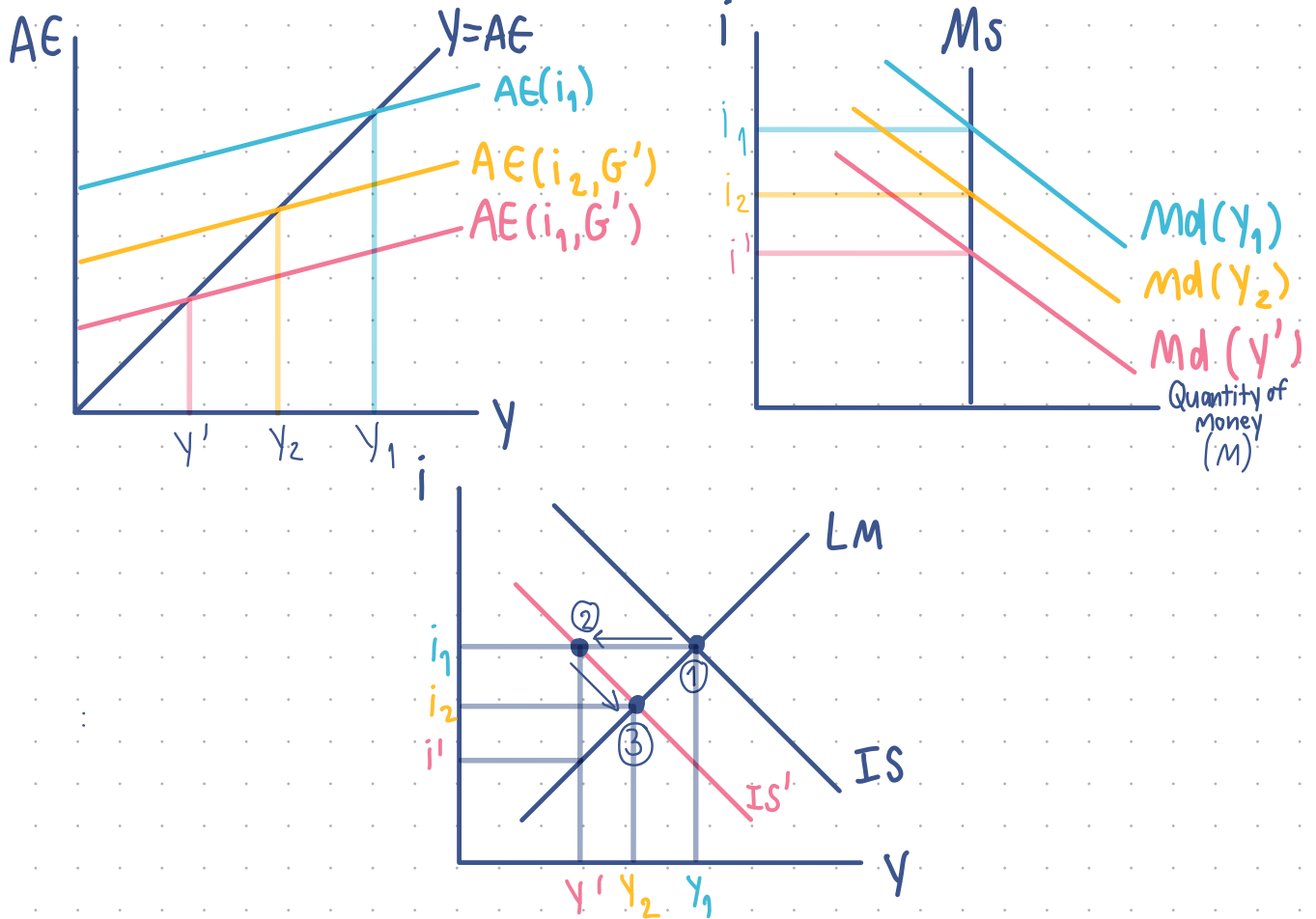
- ① GM \rightarrow When the government spending increase ($G \uparrow$), this raises demand in the economy ($AE \uparrow$). Firms produce more to supply at higher demand ($\rightarrow Y=AE$). This raises output and hence income ($Y \uparrow$) in the economy.
- ② MM \rightarrow When people have more income ($Y \uparrow$), they want to buy more goods. This raises the money demand ($Md \uparrow$). So, it raises interest rate ($i \uparrow$).
- ③ GM \rightarrow However, higher interest rate (i) discourages investment ($I \downarrow$). With lower investment, output falls ($Y \downarrow$) \Rightarrow Crowding-out effect

\therefore As a result, the new equilibrium has higher output and interest rate

“ Y_1 to Y_2 is crowding-out effect ”

↳ happen when government using fiscal policy [$G \uparrow$]

Ⓑ Contractionary $\rightarrow G \downarrow$



- ① $GM \rightarrow$ When the government spending decrease ($G \downarrow$), demand in the economy will decrease ($AE \downarrow$). Firms produce less. This falls output and income ($y \downarrow$) in the economy.
- ② $MM \rightarrow$ When people have less income ($y \downarrow$), they don't want to buy goods. This falls the money demand ($Md \downarrow$). So, it falls the interest rate ($i \downarrow$).
- ③ $GM \rightarrow$ In low interest rate ($i \downarrow$), it will encourage investment ($I \uparrow$). So, demand for economy increase ($AE \uparrow$) and also firm will produce more output ($y \uparrow$).

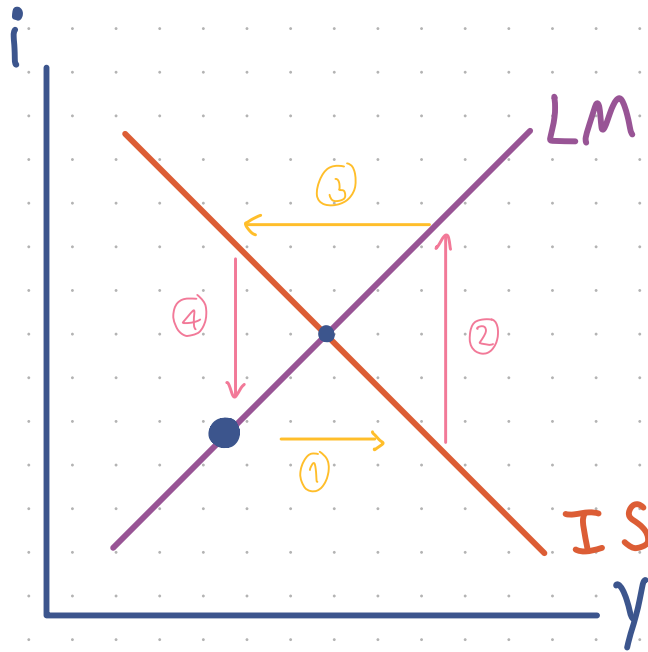
\therefore Therefore, the new equilibrium has lower output and interest rate.

Question 2

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Draw the IS-LM diagram. **Pick ANY point on either the IS curve or the LM curve** (NOT the general equilibrium point). **อย่าว่าเลือกจุดไหนก็ได้ที่อยู่บนเส้น IS หรือ LM ที่ไม่ใช่จุดตัดตรงกลางของสองกราฟ**

Use the diagram that you draw to briefly explain how the two markets at **your current point** will adjust towards the general equilibrium.



The point is located on LM curve, and not in IS curve.
it mean that the money market is in equilibrium, but goods and service market is not in equilibrium.

First, in goods and service market, the lower interest rate ($i \downarrow$) makes the investors want to investment more ($I \uparrow$) and also increase the output and income ($Y \uparrow$)

Second, in money market, when people have high income ($Y \uparrow$), the money demand increase ($Md \uparrow$), it will make the interest rate increase too ($i \uparrow$)

Third, in goods and service market, the higher interest rate ($i \uparrow$) discourage investors to invest ($I \downarrow$) and also output and income will decrease ($Y \downarrow$)

Forth, in money market, when people have less income ($Y \downarrow$), the money demand decrease ($Md \downarrow$), it will make the interest rate decrease ($i \downarrow$)

Question 3

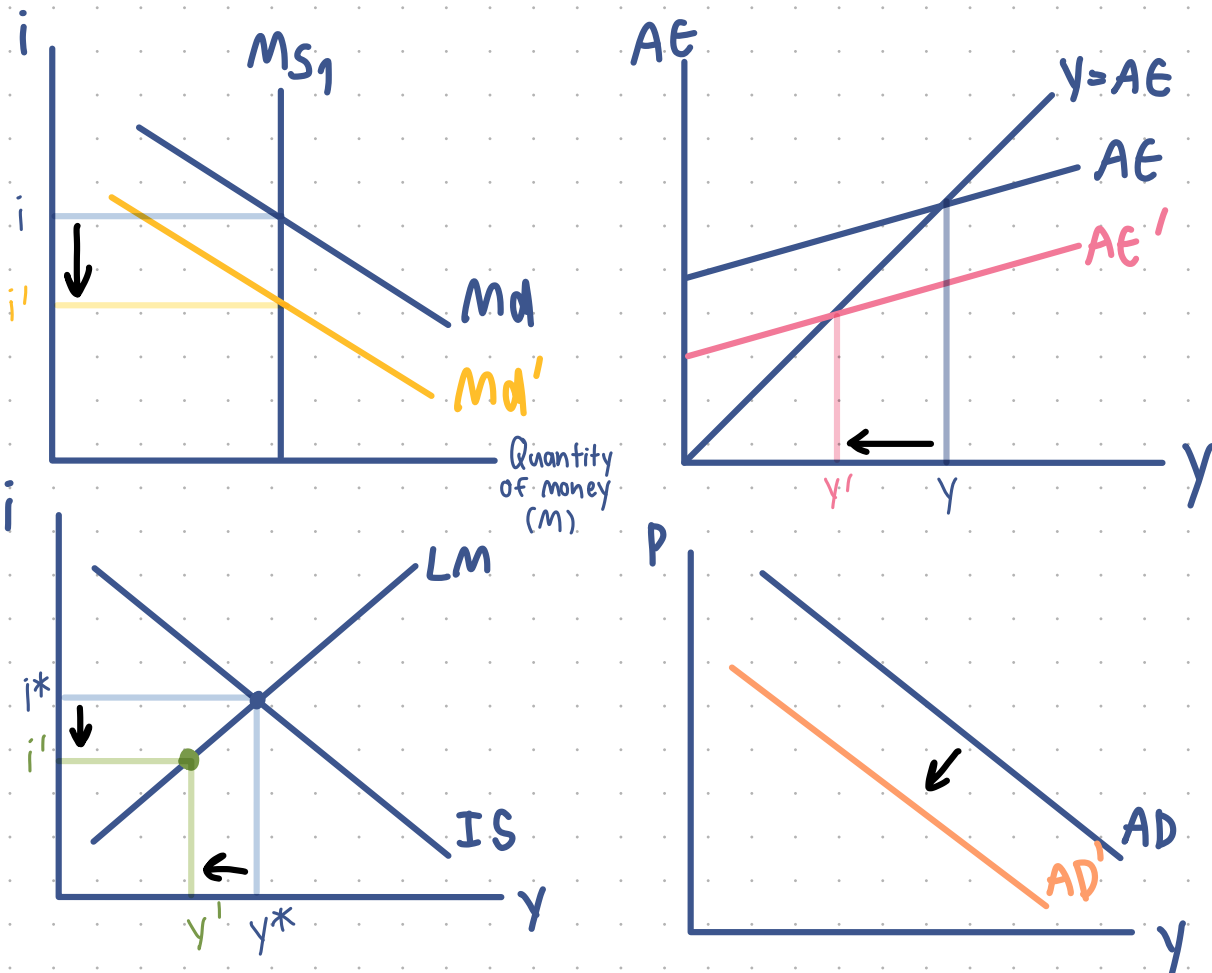
Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_Y Y - L_i i$.

Note that L_0 is **autonomous money demand**, while other terms are the same as in the lecture slides.

Now suppose that L_0 falls.

- Give ONE reason why this may happen.
- Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).

A L_0 is autonomous money demand of the function. So, if L_0 is fall means the constant number decrease and price falls. Money demand decrease



First, in Money market curve, the money demand falls from Md to Md' . the interest rate falls ($i \downarrow$).

Second, in Keynesian cross, the AE shift down (AE to AE'). it will make output decrease (Y to Y')

Lastly, in IS-LM curve, when Md shift down, it will make only movement along the curve (down $\rightarrow i^*$ to i' and y^* to y')

So, They makes AD shift down AD to AD'