

Final Exam Quiz

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

ปล ผมจดไว้แล้วนะครับว่าตอนมิตเทอมใครลอกของใคร ครั้งนี้ขอเตือนเลยที่ผมไม่ยอมแล้วนะครับ

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.

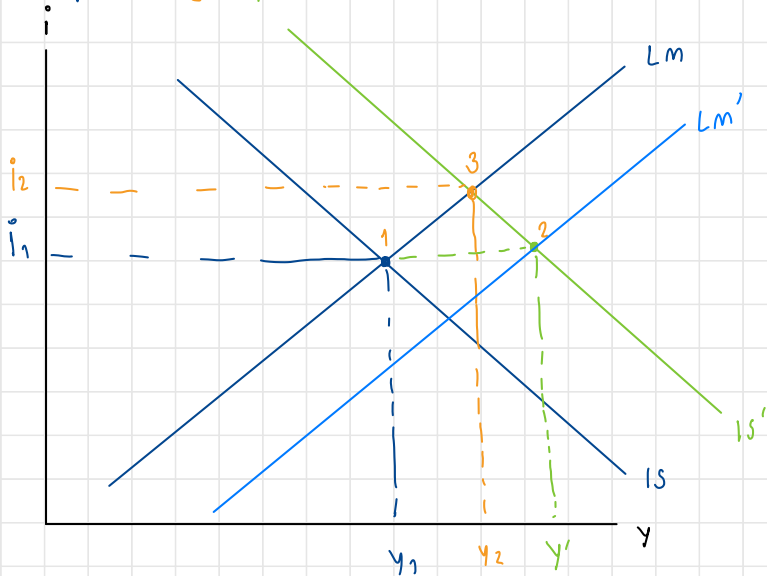
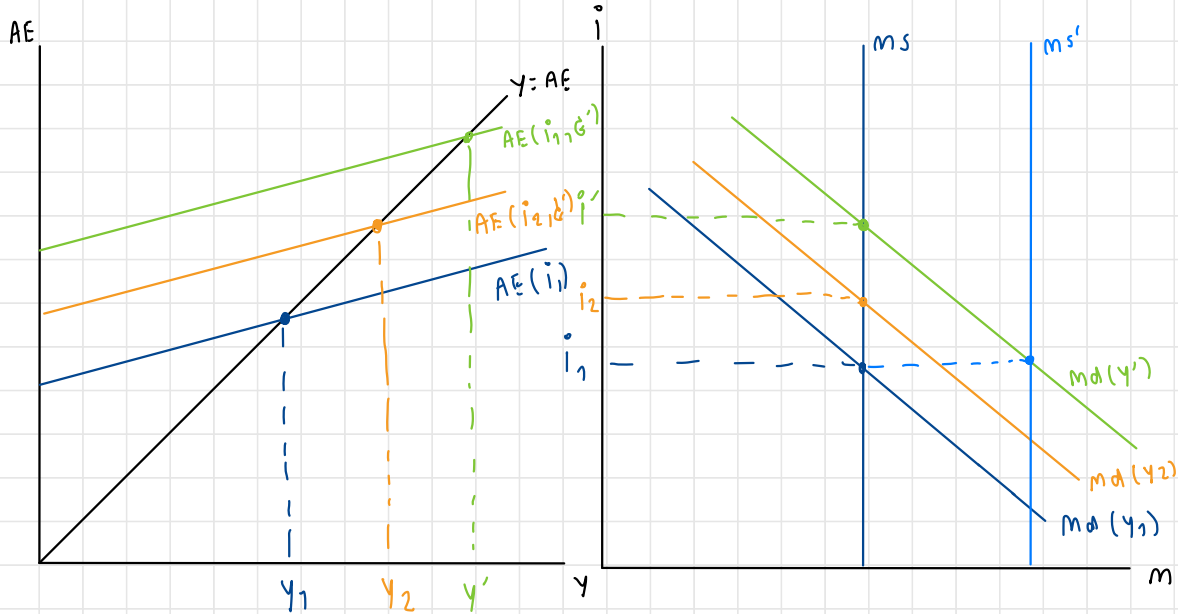
- Give ONE reason why this may happen.
- Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).

Question 1

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.) Fiscal Policy G increase \rightarrow Crowding out effect



In $IS-M$, when G increase, AE will shift up from $AE(i_1, G)$ to $AE(i_1, G')$ so Y increase from Y_1 to Y' . Then IS shifts to the right from IS to IS' . Actually, output will be at Y' (there is no equilibrium, so that it will adjust to point 3). In MM , when income (Y) increase, it means that people are richer now, so it will lead to make M_d increase from $M_d(Y_1)$ to $M_d(Y')$. After that, i will increase from i_1 to i' . In $IS-M$, because of higher i , investment will fall, so it make AE also fall from $AE(i_1, G')$ to $AE(i_2, G')$ and Y also fall from Y' to Y_2 . After that, when Y (income) fall, in MM M_d shift down from $M_d(Y')$ to $M_d(Y_2)$ and interest rate will fall from i' to i_2 . The step will continue to equilibrium at point 3.

★ In the fiscal policy, when G increase, Y_1 should increase to Y' . However, because of the crowding out effect, Y' fall to Y_2 because of higher interest rate.

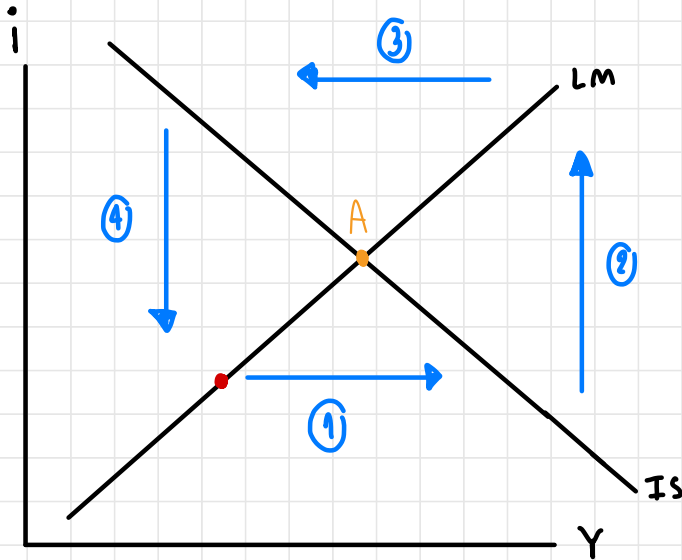
b.) To avoid crowding out effect, we will use both fiscal policy together with monetary policy.

In MM , we need to reduce interest rate, so that M_s shift right from M_s to M_s' , so that i_2 fall to i_1 again. In $IS-M$, lower interest rate will boost I (investment) and AE increase from $AE(i_2, G')$ to $AE(i_1, G')$ and Y increase from Y_2 to Y' . In MM , LM shift right (because of higher M_s) from LM to LM' , so we will same interest rate at i_1 and output, (Investment) also increase at Y' . So, at point 2, there is no 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.



Now, we are at red point on Lm curve.

- 1.) In good & service market \rightarrow now we are produce less than equilibrium, the inventories dissipate, so firm will produce more that make y increase
- 2.) In money market \rightarrow when Y (income) increase, m_d will increase, so that make interest rate increase.
- 3.) In good & service market \rightarrow As higher i , I falls, and also Y falls.
- 4.) In money market \rightarrow when y (income) falls, m_d falls, and then interest rate decrease.

The process will continue until it reach the equilibrium point at $IS = LM$ at point A.

Question 3

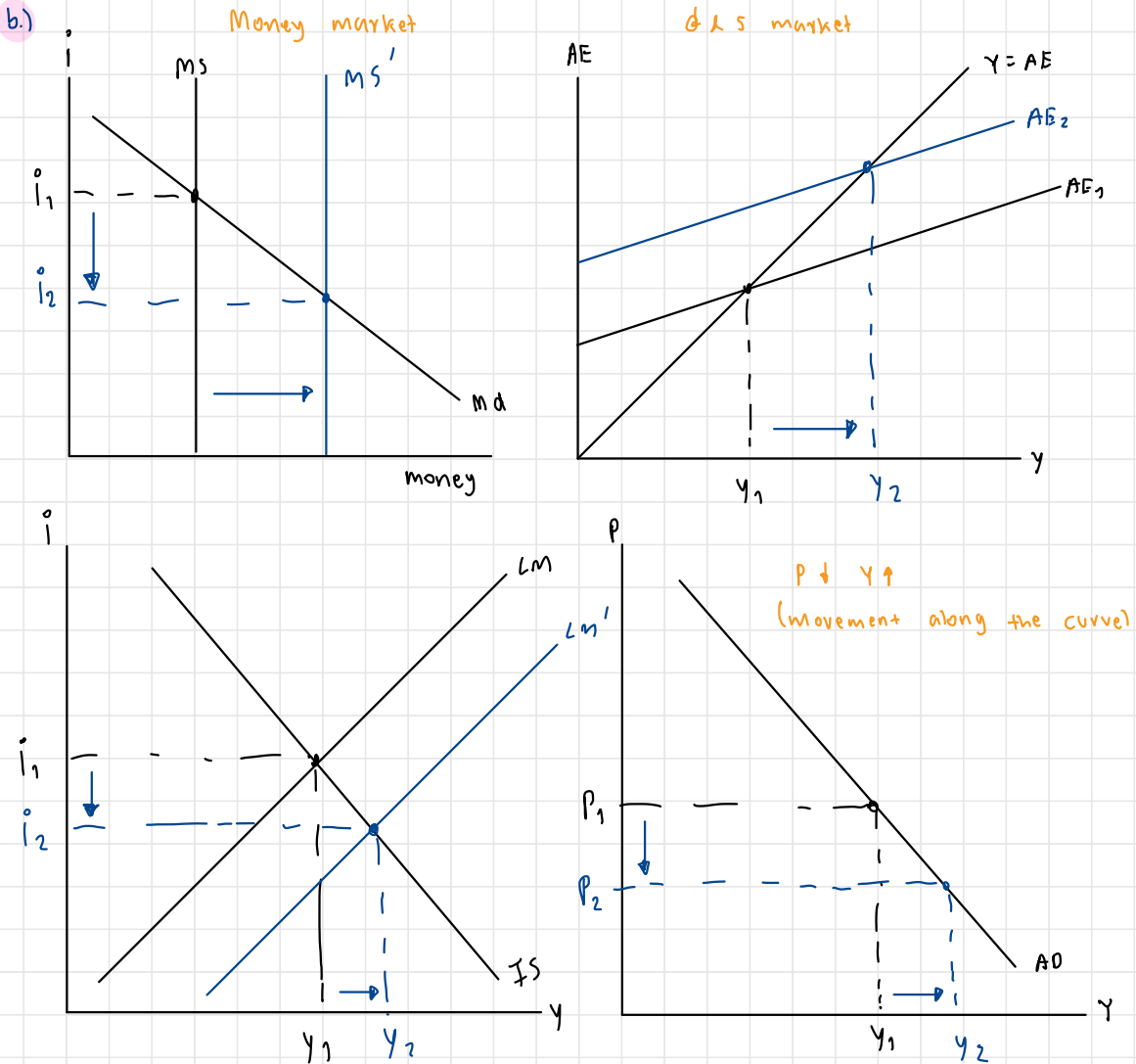
Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_1 Y - L_2 i$.

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 not depend on Y (income) and interest rate. The reason that L_0 fall because of price (P) fall. To clarify, when price fall, money demand also falls but money supply will increase.



When price decrease, in MM, it will increase money supply from M_s to M_s' , so it make interest rate decrease from i_1 to i_2 . Therefore, it make LM also shift to the right from LM to LM' and output will increase from y_1 to y_2 . At the same time, in IS, when interest rate decrease, it encourage investor to invest so AE curve shift up from AE to AE' and output increase from y_1 to y_2 . As a result, it make AD curve has a downward sloping because when price decrease, output increase.