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**Quiz EE212**

**Time allowed: 1 hour from 19.00 – 20.00**

**Submission time: 15 minutes**

**Latest submission by 20.15**

**Do not write too much. Brief explanation is sufficient.**

1. Use TWO relevant diagrams to explain how the IS curve is derived from the goods market.
2. Use TWO relevant diagrams to explain how the LM curve is derived from the money market.
3. Use relevant diagrams to explain how the AD curve is derived from the IS-LM model.
4. Use relevant diagrams to explain how the SRAS curve is derived from the labor demand and the production function.

1.) IS curve shows negative relationship b/w  $Y$  and  $i$  in  $G \& S$  market

IS Curve :  $Y = C(Y-T) + I(i) + G$  ↖ I depends on I

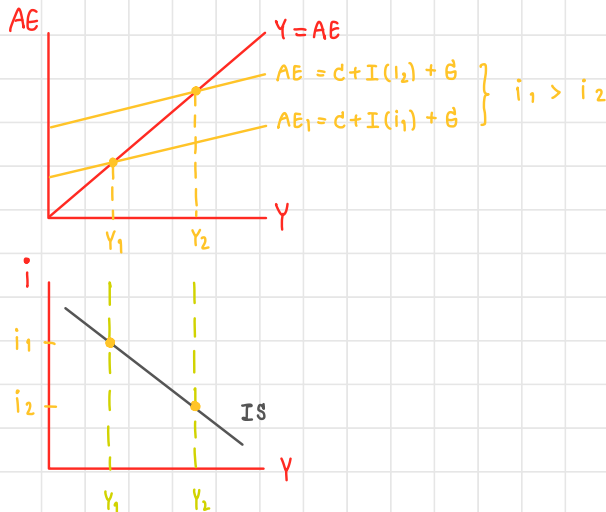
IS curve represents all Eqbm in Keynesian cross at diff level  $i$

IS Relation :  $i \downarrow \rightarrow I \uparrow \rightarrow AE \uparrow \rightarrow Y \uparrow$

1.) Suppose  $i$  decreases from  $i_1$  to  $i_2$ , lower  $i$  encourage investors and raise  $AE$ .

2.) AS a result, when  $AE$  increase,  $Y$  also increase from  $Y_1$  to  $Y_2$ .

$\therefore$  It shows negative relationship b/w  $i$  and  $Y$



2.) LM curve shows positive relationship b/w  $Y$  and  $i$  in money market

LM curve represents all eqbm in money market  $\Rightarrow M_d = M_s$

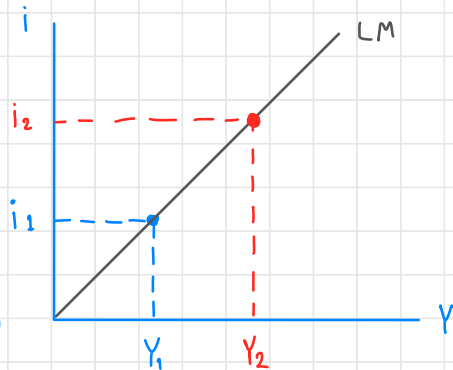
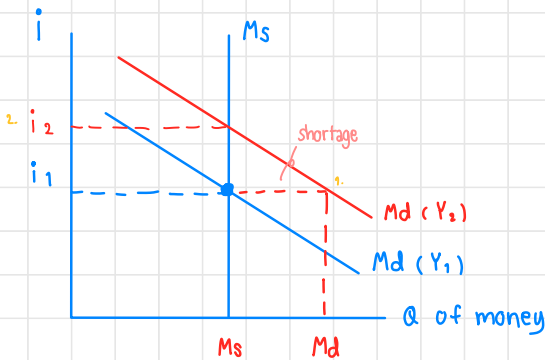
$$\begin{array}{l}
 \text{LM Relation} : \begin{array}{l}
 \overset{1}{Y} \uparrow \rightarrow \overset{2}{M_d} \uparrow \\
 \overset{3}{i} \uparrow \rightarrow \overset{4}{M_d} \downarrow
 \end{array} \left. \vphantom{\begin{array}{l} Y \\ i \end{array}} \right\} \begin{array}{l}
 M_d = M_s \\
 \leftarrow \text{Constant b/c control by CB} \\
 \leftarrow \text{depend on income}
 \end{array}
 \end{array}$$

$\therefore$  when your income goes up, you must have higher  $i$  to keep the money market in the eqbm.

1.)  $Y \uparrow$  (pp want to hold cash)  $\rightarrow M_d \uparrow$  (shift  $M_d \rightarrow$ )  $\rightarrow$  shortage of money  
 $\rightarrow$  pp will convert bond into cash

2.) PP. who wants to borrow (Bond issuer) will  $\uparrow i$  to reduce  $M_d$  ( $M_d \downarrow$ )

$\therefore M_d$  will remain equal to  $M_s$



3.) AD curve : Demands are relationship between  $P$ ,  $Y$

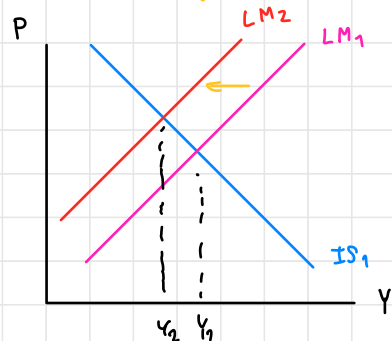
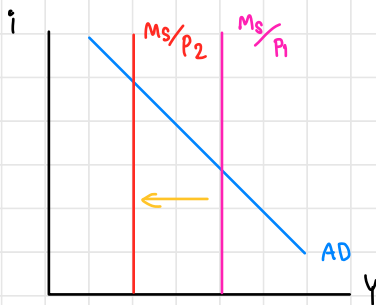
The IS curve doesn't related directly to  $P$ ,  
But  $P$  can affect IS through LM

LM curve is related to  $P$

:  $M/P = L(i, Y)$  → PL change, LM shifts  
↳ price level  
(  $P \uparrow, LM \leftarrow$  /  $P \downarrow, LM \rightarrow$  )

So, we will derive AD curve from LM curve

1. When  $P \uparrow$ , there is a decreasing in Real money supply
2. smaller real Ms,  $i \uparrow \rightarrow I \downarrow \rightarrow Y \downarrow$
- 3 AD relationship:  $P \uparrow \rightarrow Y \downarrow$



#### 4.) Deriving SRAS by labor demand and production function

□ When price  $\uparrow$ , real wage  $\downarrow$ , firms hire Labor  $\uparrow$  and increase output.

$\therefore$  SRAS shows the positive relationship b/w  $P, Y$

