

EE212 Principles of Macroeconomics, 2/2016 (Sec. 046401)

Problem Sets 3 :

Chapter 6. ISLM Model

Please submit at the BE office, 5th floor department of Economics building.

Deadline of submission : April 7, 2016, before 15.00 hrs.

Late submission will not be accepted. Please do all questions on your own paper sheets. Attach your paper sheets with the question sheet and then submit on or before the due date.

1. Within the IS-LM curve model, show how income and the interest rate are affected by each of the following changes.
 - (a) An increase in government spending
 - (b) An autonomous decline in investment spending
 - (c) An increase in taxes
 - (d) An Increase in the money supply.
2. Answer all parts of this question.
 - (a) Consider an economy where the money demand is very sensitive to interest rate while investments are not very sensitive to the interest rate. Using diagrams to illustrate your answer. Discuss the effectiveness of fiscal and monetary policy in such a case using the IS-LM model.
 - (b) According to monetarist view, money is not a close substitute of interest bearing assets only but it is a substitute of all possible assets. This implies that money demand is not very sensitive to the interest rate. Moreover investments are believed to be very sensitive to the interest rate. Using diagrams to illustrate your answer. Discuss the effectiveness of fiscal and monetary policy in such a case using the IS-LM model.