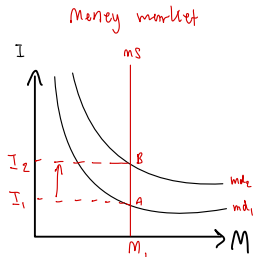
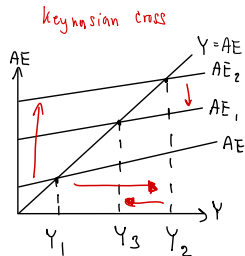
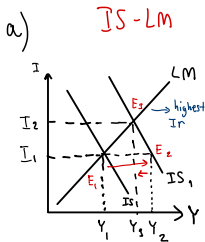


Question 1

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

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



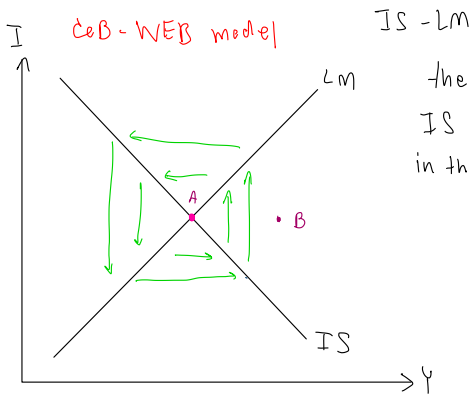
Crowding-out effect is the government spending has increased to reduce the private sector spending. Y_1 increase to Y_2 ($\Delta + E_g$). Then it makes interest rate increase. As a result, it makes Y_2 decrease to Y_3 .

b) Avoiding crowding-out effect, Government may use tax to reduce. Furthermore, the monetary policy can control money supply because the central bank need to reduce or increase money supply to control interest rate.

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.



the pink point is only the IS curve mean that it's not in the general E point

To adjust the general equilibrium, bank has to raise up the I that makes investment decrease and also output, income will fall.

After that, the bank must reduce I to increase investment that raise output and income. Last but not least, it will be a circle dynamic and adjust to general equilibrium of two markets.

Question 3

Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_1Y - L_2i$.

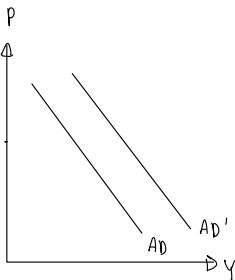
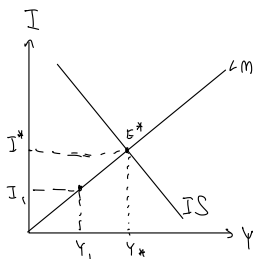
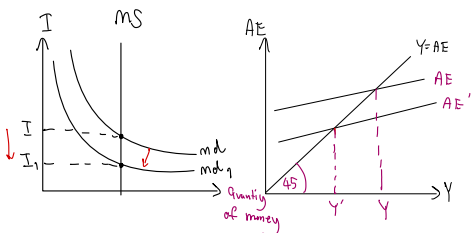
Note that L_0 is **autonomous money demand**, while other terms are the same as in the lecture slides.

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.) The one reason is L_0 fall \rightarrow Price decrease, so people don't want to have cash anymore.

b.)



Fall in liquidity (L_0) means the money demand in Econ falls (md shift to the left) resulting in falls in output (AE) and income (Y_1)