

Quiz EE212

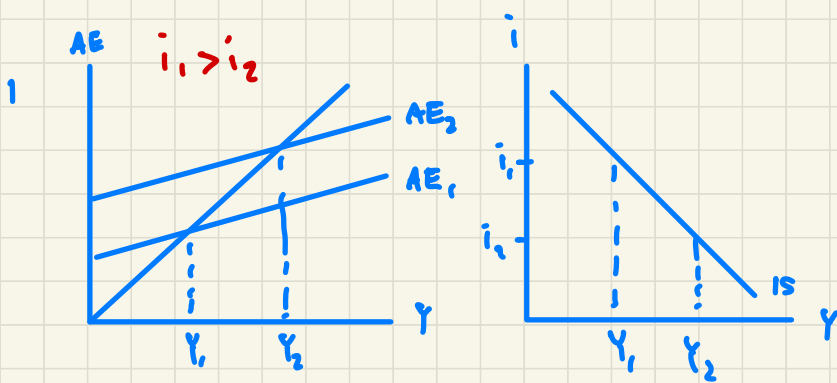
Time allowed: 1 hour from 19.00 – 20.00

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.



The goods market is in equilibrium when aggregate demand is equal to income. The aggregate demand is determined by consumption demand and investment demand

IS curve relates different equilibrium levels of national income with various rate of interest

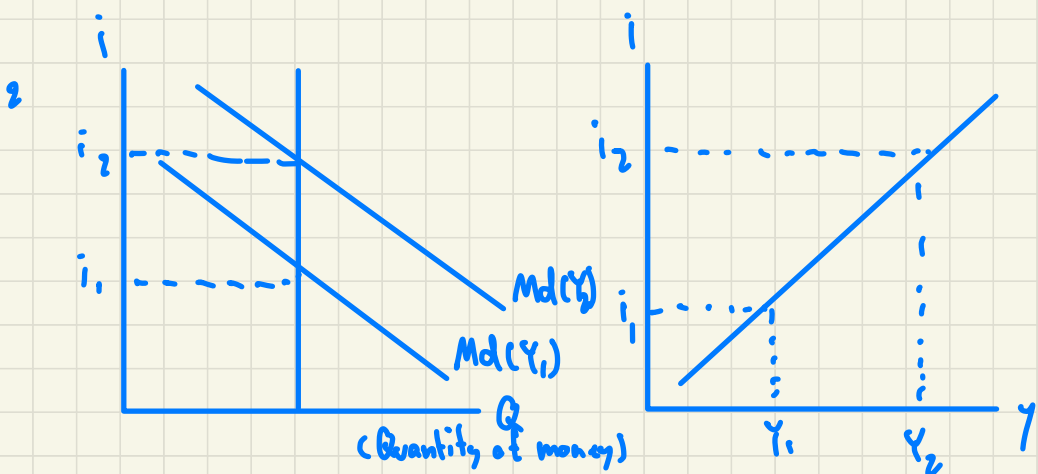
As you can see from goods market diagram, interest rate of AE₁ is greater than AE₂

So in IS graph, due to interest rate decrease

→ Investment will increase

→ AE will increase

As a result Y will increase

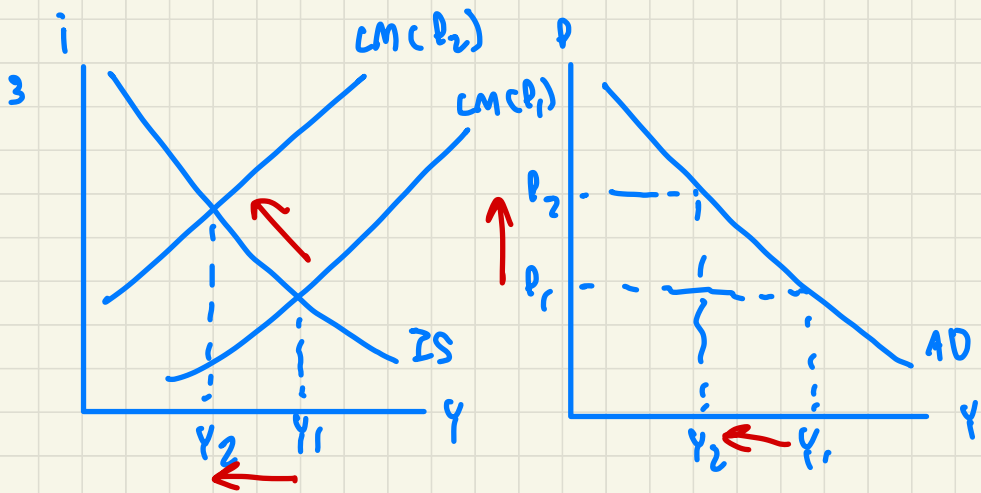


to derive the LM curve it must be in money market condition which $M_d = M_s$

- Note that M/P is constant

when i change, Y has to change too in order for equality to hold.

- When i increase, Y will increase because i increase mean $M_d \downarrow$ and when $Y \uparrow$ mean $M_d \uparrow$ so two changes in M_d will cancel out each other ($M_d = M_s$)



IS curve is not directly relate \rightarrow P but, P can affect IS through LM

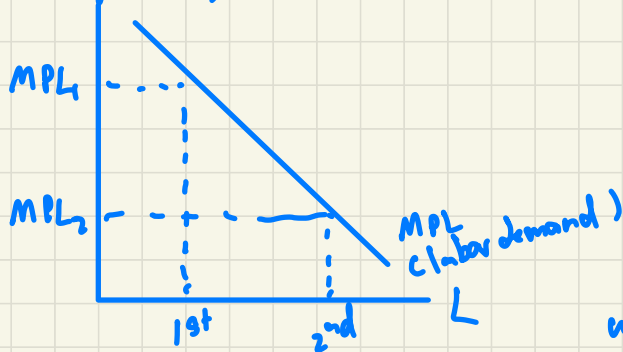
LM curve is directly relate to P because
 $M/P = L(i, Y)$

- \rightarrow An increase in P will reduce the Real Money Supply
- \rightarrow Small Real M_s will increase interest rate
- \rightarrow High interest rate will lower investment
- \rightarrow Lower investment will reduce output (Y)

As a result AD relationship : $P \uparrow$ lead to $Y \downarrow$

4 Labor demand is depend on
 The profit maximizing and is due to $w/p = MPL$

real wage (w/p)



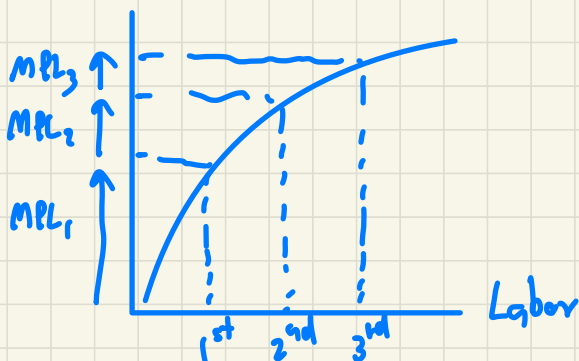
high MPL for the first unit of labor employed, firms are willi to pay high real

wage to the 1st worker for 2nd worker low MPL (firms pay less) (less productive)

For Production Function (In SR)

(Characterized by law of diminishing returns)

Output



$MPL = \frac{\Delta \text{output}}{\Delta \text{labor}} = \text{slope of the production function}$

\therefore in SR, nominal \bar{w} is sticky

As Price increase, inducing firms to hire more labor and increase output

$p \uparrow \gg w/p \downarrow \gg \text{labor demand} \uparrow \gg L \uparrow \gg Y \uparrow$