

# Group 9

## ASSIGNMENT 1: DUE FRIDAY 31<sup>ST</sup> (BEFORE 23.30) ***ANALYZE SHOCKS WITH THE IS-LM MODEL***

Use the *IS-LM* model to analyze the effects of

1. a boom in the stock market that makes consumers wealthier. (odd-numbered group)
2. after a wave of credit card fraud, consumers using cash more frequently in transactions. (even-numbered group)

For each shock,

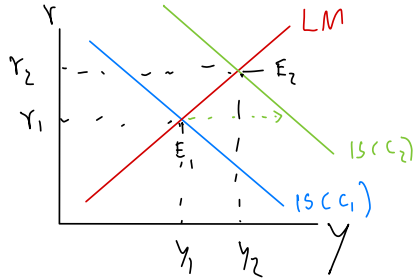
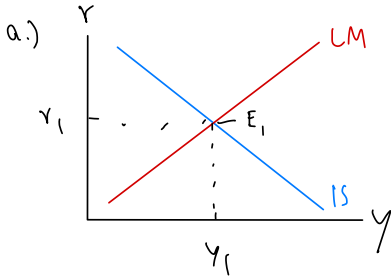
- a. use the *IS-LM* diagram to show the effects of the shock on  $Y$  and  $r$ . Explain the mechanism.
- b. determine what happens to  $C$ ,  $I$ , and the unemployment rate.

Use the IS-LM model to analyze the effects of

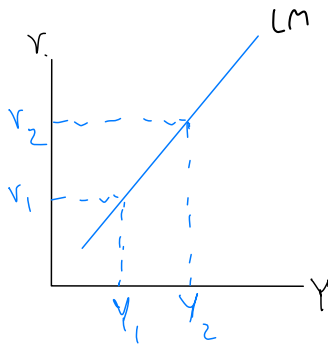
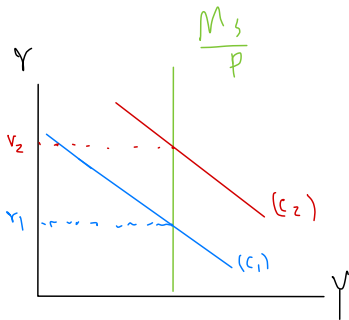
1. a boom in the stock market that makes consumers wealthier. (odd-numbered group)

For each shock,

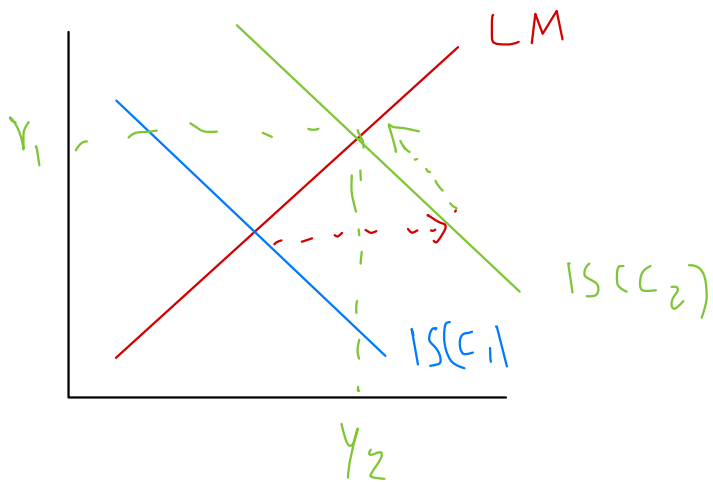
- a. use the IS-LM diagram to show the effects of the shock on  $Y$  and  $r$ . Explain the mechanism.
- b. determine what happens to  $C$ ,  $I$ , and the unemployment rate.



At first, the equilibrium of IS-LM model is at  $E_1$ . Then, a boom in the stock market makes consumers wealthier causing consumers have higher purchasing power. So,  $C$  increase. The aggregate demand also increase making  $Y$  increase. IS curve shift upward.



Since  $Y$  change making interest rate also increase, but LM move along the curve. Since, the increasing in interest rate makes investment decrease also as  $r$



In conclusion, a boom in the stock market make consumers wealthier causing output and interest rate increase, with crowding out effect.