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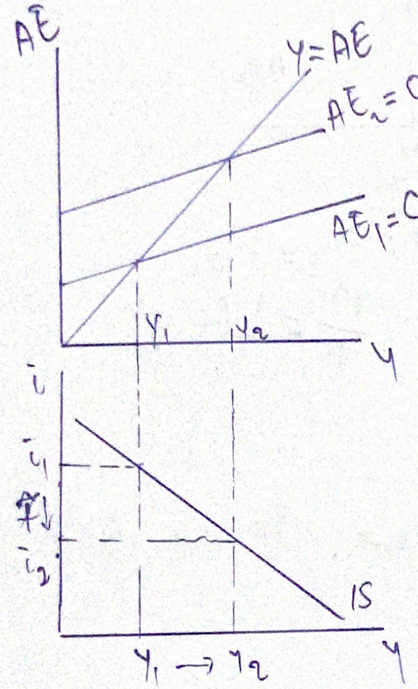
Answer

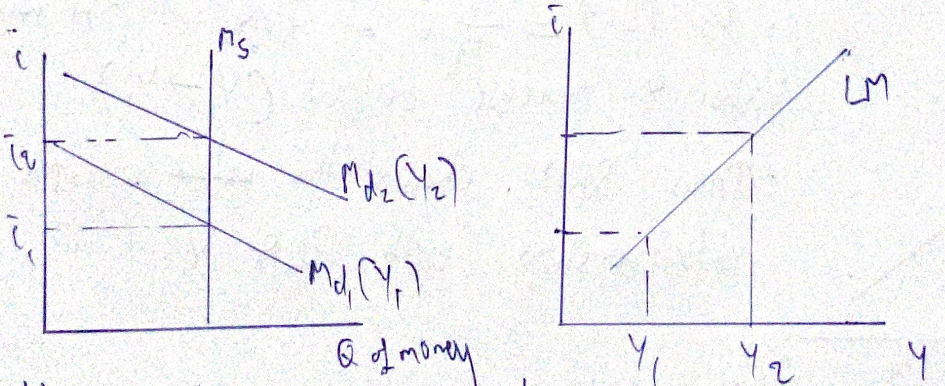
1). Derive the IS curve from the Goods market:



• The equilibrium of GM: $Y = AE$

when there is an decrease in i, investment will invest more, which make output increase ($Y_1 \to Y_2$). Therefore, output (Y) & interest (i) have negative relationship So, we get the downslope IS curve.

2). Derive the LM curve from money market:

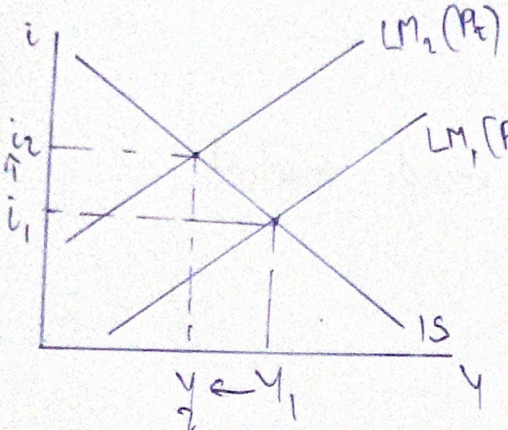


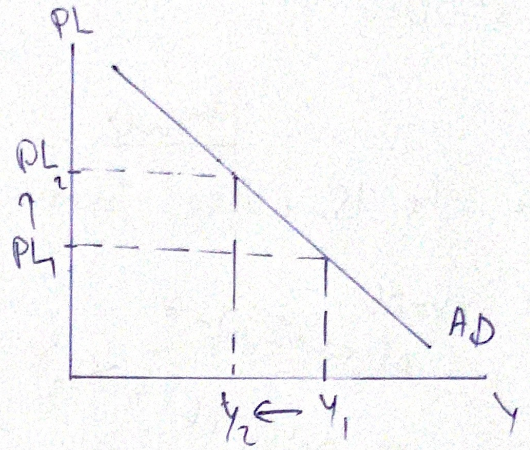
Equilibrium of money market: $M_s = M_d$:

when income increase, people will demand more money. ($Md_1 \to Md_2$)

At i_1, there will be shortage. People will try to hold money, i will increase ($i_1 \to i_2$). Therefore, output or income (Y) & interest (i) have positive relationship, So we get the positive slope LM curve.

3). Derived AD curve from the IS-LM model:





Demand & supply depend on PL & Y. LM: $M_s = M_d$

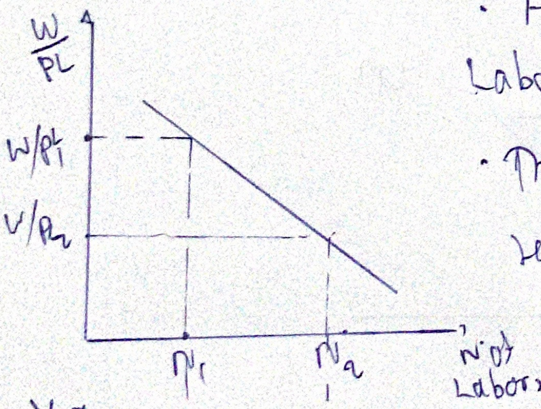
$\frac{M}{P} = L(i, y)$

When P goes up, $\frac{M}{P}$ will goes down.

$M_s \downarrow \Rightarrow i \uparrow \Rightarrow I \downarrow \Rightarrow Y \downarrow$.

Therefore, when PL goes up, Y goes down. So we get AD curve as downward curve

4). Derived SRAS curve from the labor demand & the production function:



- As PL $\uparrow \Rightarrow \frac{W}{PL} \downarrow \Rightarrow$ firm will hire more Labor & increase output. ($Y_1 \to Y_2$)
- Thus, SRAS shows the ~~relat~~ positive relationship with PL & Y