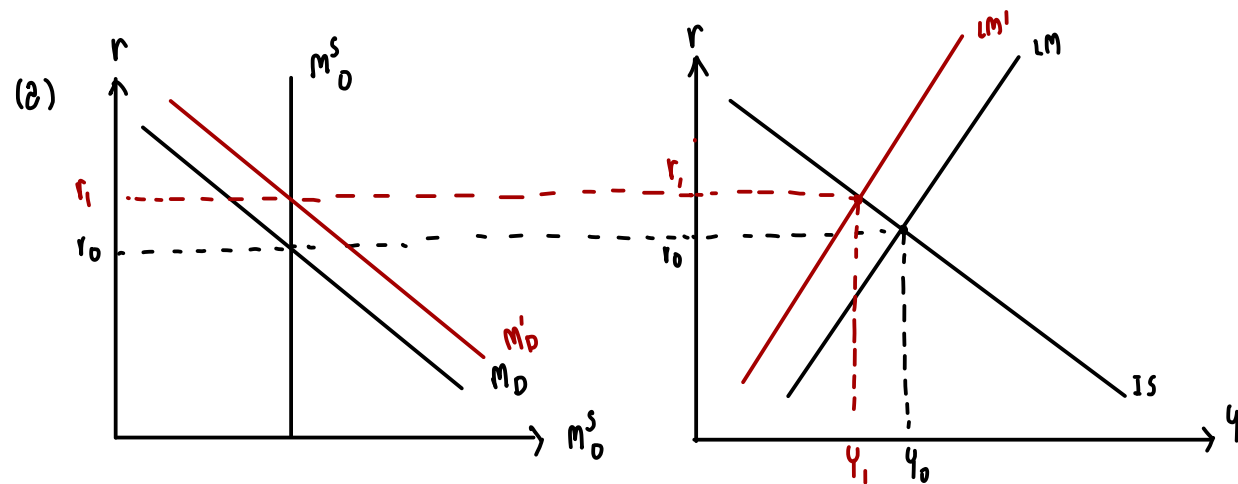


Assignment 1 #EE319



From the given situation, people will be afraid to use credit cards, so they will hold more money as a result. Therefore, money demand will increase and shift upward. Then, we derive the LM curve from this situation which shifts upward from LM to LM'. From the result, the interest rate increases from r_1 to r_0 and at the new equilibrium, the output will decrease from Y_0 to Y_1 .

(b) From the information above, we can interpret that the increase in the interest rate is leading to a decrease in income. With a decrease in income, consumption and investment will decline. Hence, people have less money to hire employees, and the unemployment rate will rise as a result.

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