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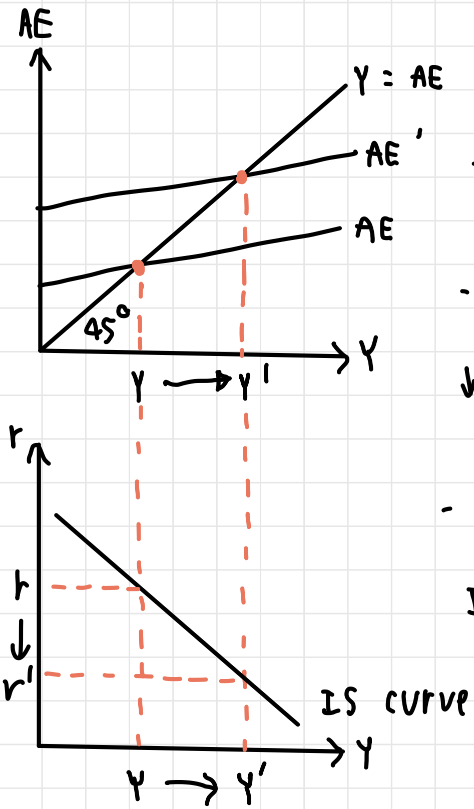
1




- Change in r, while keeping G & T constant

- ↓ r causes rise in investment

↓ r → I ↑ → AE ↑ (AE → AE') → Y ↑ (Y → Y')

- This explains IS curve.

Inverse relationship between r and Y

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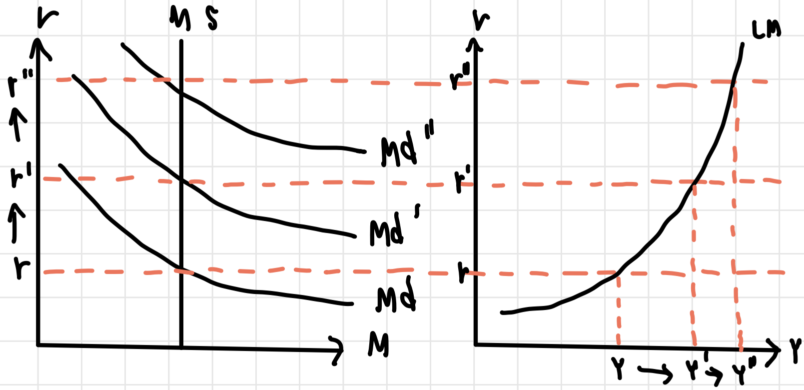
2




- Md is determined by the liquidity preference theory
- Ms is determined by central bank, so Ms is not affect by r
- M/P is constant. Therefore, when r changes, Y has to change too in order for the equality to hold.
- R↑ → Y↑. This shows positive relationship between r and Y.

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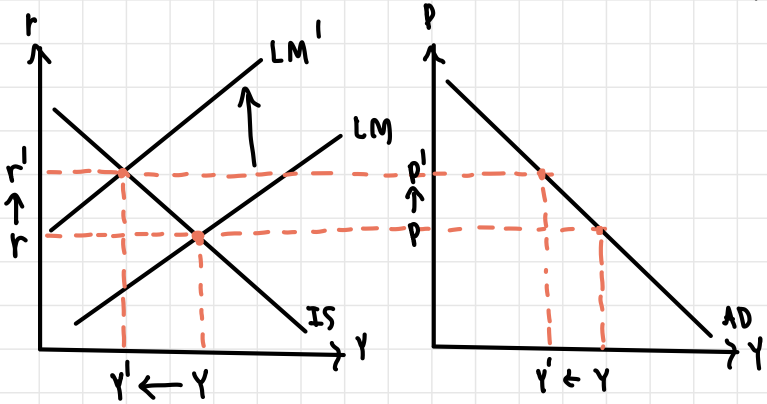
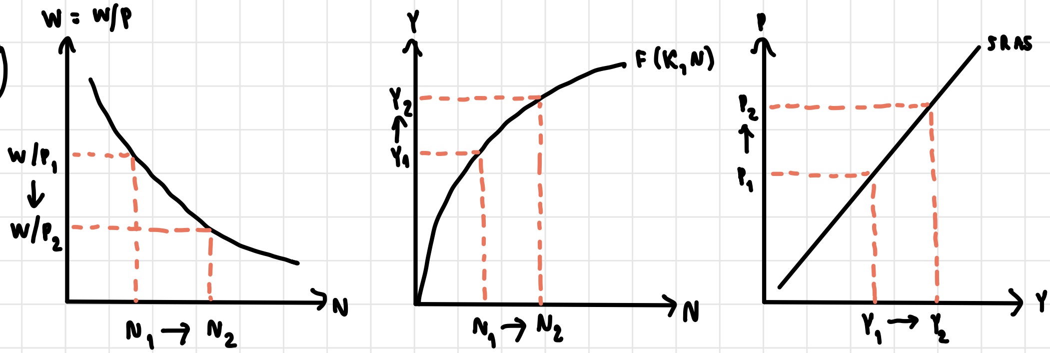
(3)




- Price ↑ causes Real Money Supply (M/P)↓. This leads to M↓(LM → LM'). Then Y ↓ (Y → Y')
- AD curve has increase relationship between P and Y.

(4)




- Price ↑ causes real wage falls ($W/P_1 \rightarrow W/P_2$), including firm to hire more labor ($N_1 \rightarrow N_2$) and increase output ($Y_1 \rightarrow Y_2$).
- P↑ > W/P↓ > Labor Demand ↑ > Labor↑ > Y↑
- SRAS shows the positive relationship between P and Y.