

Perichayaz

6404640929

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.

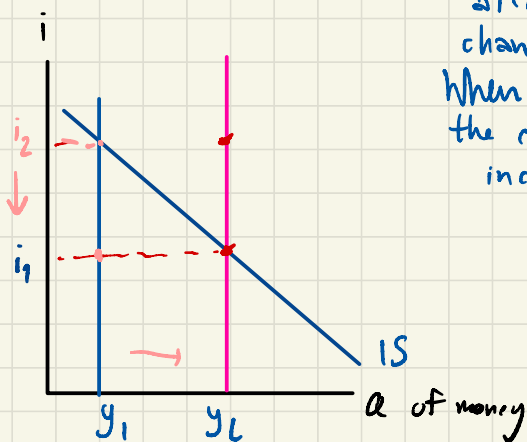
1. Use TWO relevant diagrams to explain how the IS curve is derived from the goods market.

if $i \downarrow$ $I \uparrow$: $AE \uparrow$



→ IS curve shows a negative relationship between i and Y in the commodity market.

→ Investment depends on interest rate.

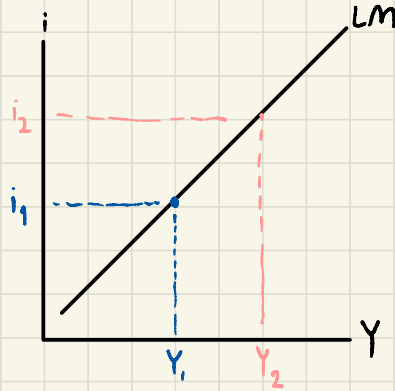
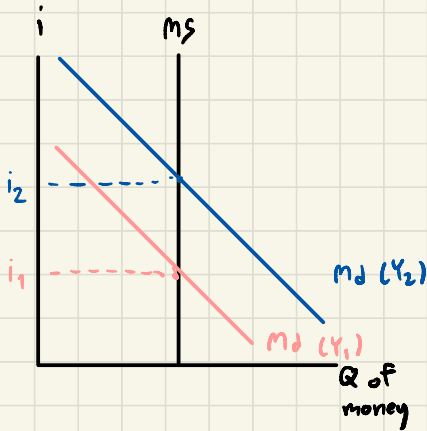


→ the changes in the interest rate affect aggregate expenditure by causing changes in investment demand.

When the interest rate falls, it lowers the cost of investment projects and thus increases the profitability of investment. Therefore, entrepreneurs will make more investments when the interest rate is lower.

Note: $(I_0 - I_1 C_i)$

2. Use TWO relevant diagrams to explain how the LM curve is derived from the money market.



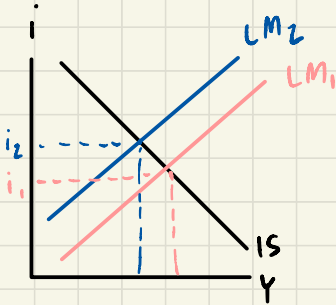
LM relation : $Y \uparrow \rightarrow M_d \uparrow$; $M_d = M_s$
 $i \uparrow \rightarrow M_d \downarrow$

→ Real money supply (M_s) is determined by the central bank and is constant

→ $M_s = \frac{M}{P}$; M : nominal amount
 P : price level

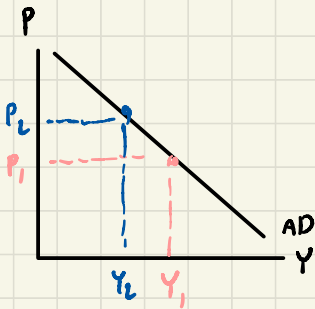
→ When people have more income, people want to hold more money.

3. Use relevant diagrams to explain how the AD curve is derived from the IS-LM model.



→ Suppose that we hold the nominal money supply constant. So, if the price level rises, the supply of real money balances (\bar{M}) will fall. As a result, the LM curve shift upward to the left

$$i \uparrow \rightarrow I \downarrow \rightarrow AE \downarrow \rightarrow Y \downarrow$$



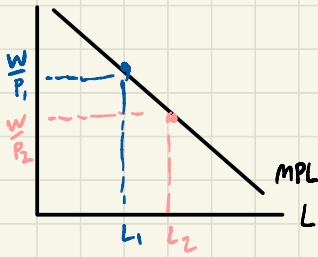
→ Slope of AD is downward because as price level increase so the output decrease.

4. Use relevant diagrams to explain how the SRAS curve is derived from the labor demand and the production function.

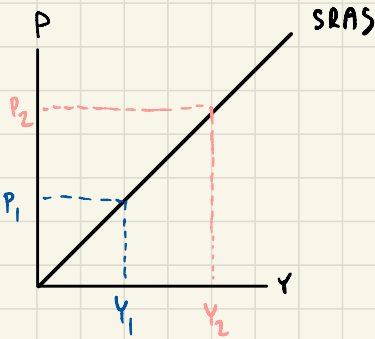
L: Labor
 $\frac{W}{P}$: real wage
 Y: income

$$N = L$$

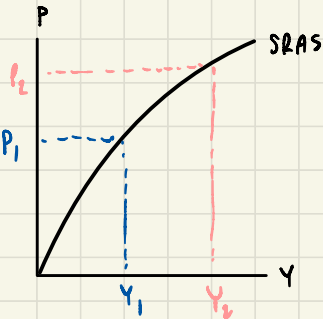
$$MPL = \frac{W}{P}$$



$$P \uparrow \rightarrow \frac{W}{P} \downarrow$$



SRAS derived from labour market and production function.
 When the price level rises, real wages fall, so firms must hire more workers and produce more Y.



$$P \uparrow \rightarrow \frac{W}{P} \downarrow \rightarrow \text{labour demand} \uparrow \rightarrow L \uparrow \rightarrow Y \uparrow$$