Quiz

Answer

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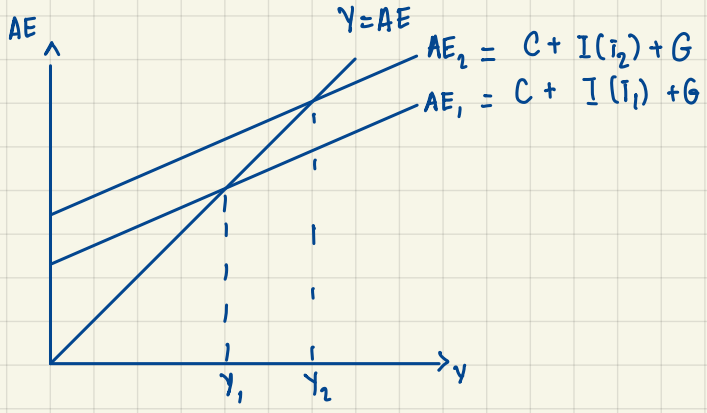
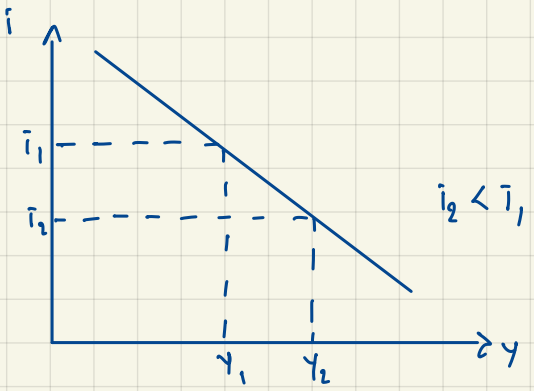
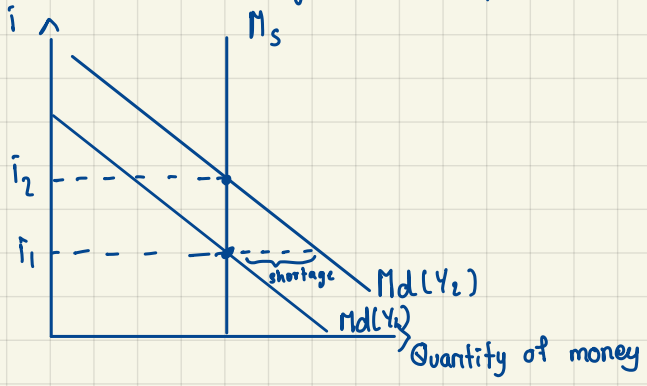
1. Two relevant diagrams that explain IS curve derive from the goods market.

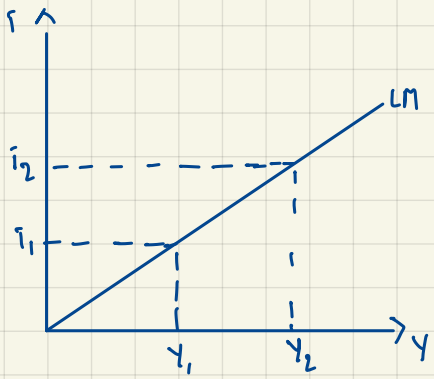




IS curve derived from keynesian cross graph. IS curve also indicates the negative relationship between i and Y. This is because when i increases, it discourages investors to invest which makes AE and Y falls. IS curve relations: $\bar{i} \uparrow \rightarrow I \downarrow \rightarrow AE \downarrow \rightarrow Y \downarrow$

2. Two relevant diagrams that explain how LM curve derives from money market.

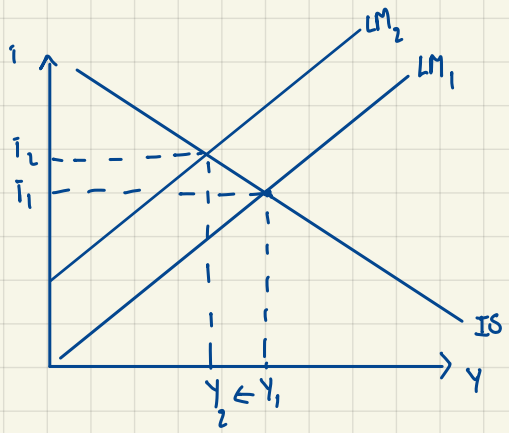


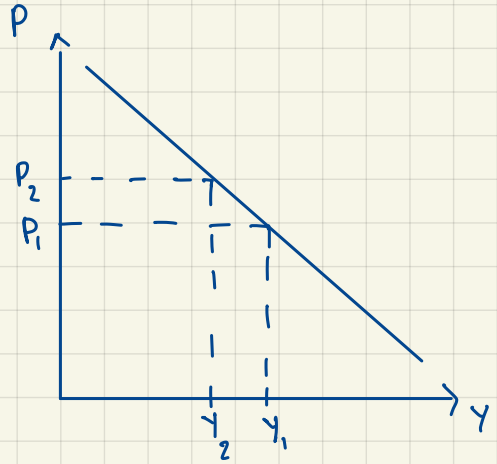


LM curve derives from money market, and it shows the positive relationship between i and Y. This is because when Y increases (people become richer), they want to hold more cash, so M_d rises which makes i increases too. But, when i increases, M_d will go down to equate with M_s.

So, LM curve relation is $Y \uparrow \rightarrow i \uparrow$

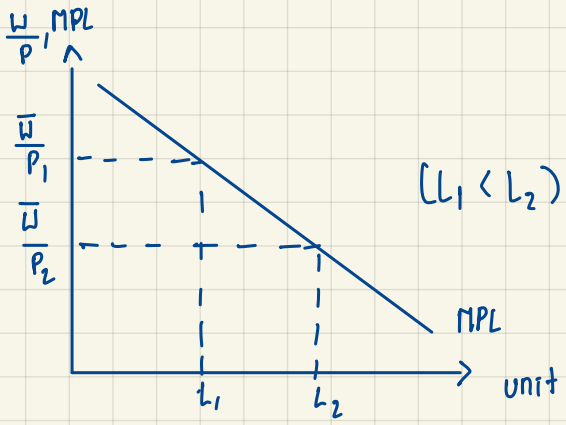
3. The derive of AD curve

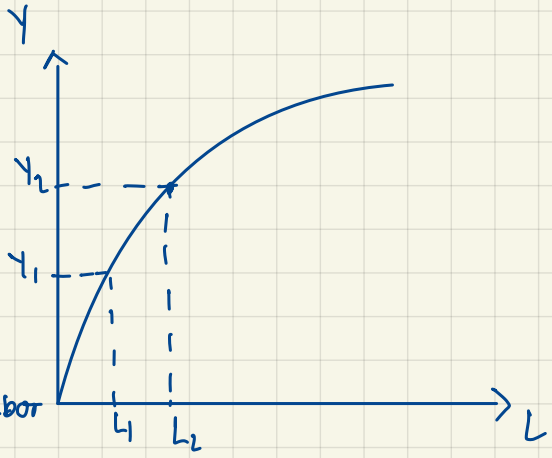


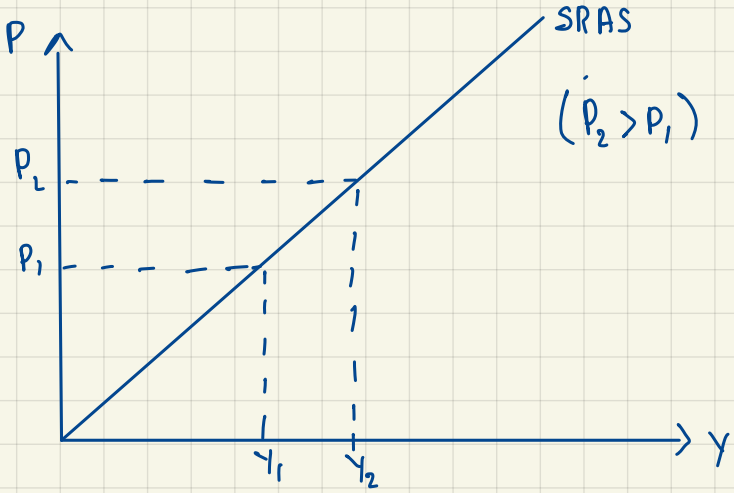


AD curve is derived from IS-LM. The shift in LM that is due to the change of P(price level) will make the movement along IS. When P goes up, Y goes down because real Ms goes down.

4. how SRAS is derived







When P increases, cost of hiring labor decreases because in short-run, wage is sticky. Thus, firm will demand more labor. $(L_1 \rightarrow L_2)$.

With the increase of Labor $(L_1 \rightarrow L_2)$, there will be the increase in Y too $(Y_1 \rightarrow Y_2)$

Therefore, SRAS has the positive relationship between P and Y.