Final Exam Quiz

THOSE WHO COPY YOUR FRIENDS OR LET YOUR FRIENDS COPY YOU WILL BE AWARDED ZERO.

ปล ผมจดไว้แล้วนะครับว่าตอนมิดเทอมใครลอกของใคร ครั้งนี้ขอเตือนเลยว่าผมไม่ยอมแล้วนะครับ

ผมต้องลงโทษ ไม่งั้นต่อไปคงไม่มีใครอยากซื่อสัตย์

Submission Guide: You can upload up to 3 files on Moodle. If the whole file is too large, you should break it down and upload 3 files, each containing 1 question.

<u>Question 1</u>

Draw 3 diagrams (Keynesian Cross, Money Market, IS-LM) to **<u>show and briefly explain</u>** the followings:

a. The crowding-out effect when the government increases its spending
b. Another policy that can be used to avoid the crowding-out effect

<u>Question 2</u>

Draw the IS-LM diagram. **<u>Pick ANY point on either the IS curve or the LM curve</u>** (NOT the general equilibrium point). ย้ำว่าเลือกจุดไหนก็ได้ที่อยู่บนเส้น IS **<u>หรือ</u>** LM **<u>ที่ไม่ใช่จุดตัดตรงกลางของสองกราฟ</u>**

<u>Use the diagram that you draw to briefly explain</u> how the two markets at **<u>your current point</u>** will adjust towards the general equilibrium.

<u>Question 3</u>

Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_Y Y - L_i i$.

Note that **L_0 is autonomous money demand**, while other terms are the same as in the lecture slides.

Now suppose that L_0 falls.

a. Give ONE reason why this may happen.
b. Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).

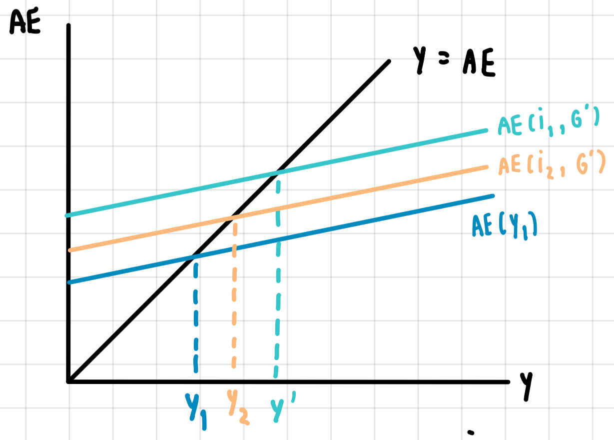
Question 1

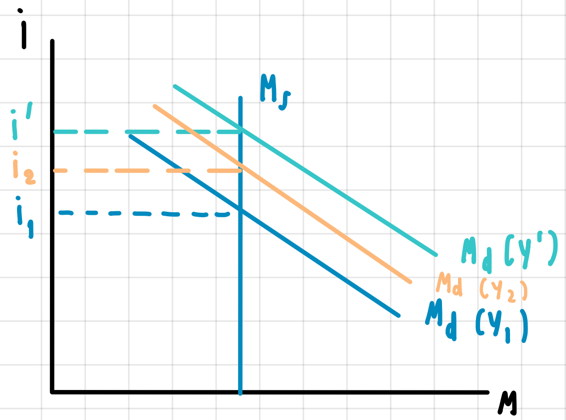
Draw 3 diagrams (Keynesian Cross, Money Market, IS-LM) to **show and briefly explain** the followings:

a. The crowding-out effect when the government increases its spending $G \uparrow \rightarrow Y \uparrow \rightarrow AE \uparrow$

b. Another policy that can be used to avoid the crowding-out effect

a.)





(1) GM : $G \uparrow \rightarrow AE \uparrow \rightarrow Y \uparrow$

(2) MM : $Y \uparrow \rightarrow M_d \uparrow \rightarrow i \uparrow$

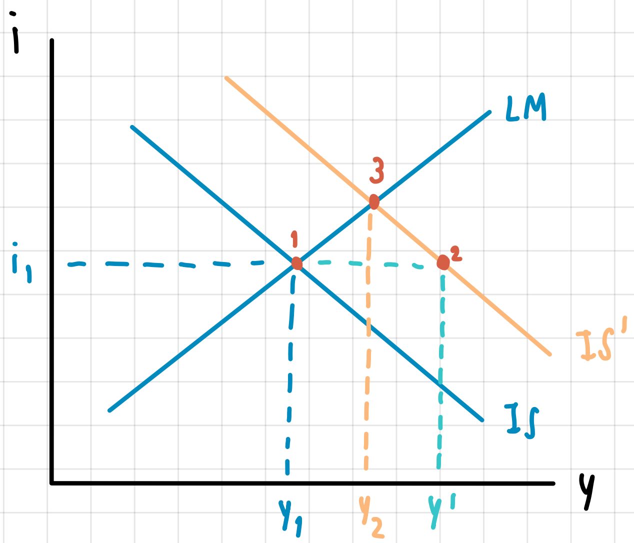
(3) GM : $i \uparrow \rightarrow I \downarrow \rightarrow AE \downarrow \rightarrow Y \downarrow$

(4)

(5)

⋮

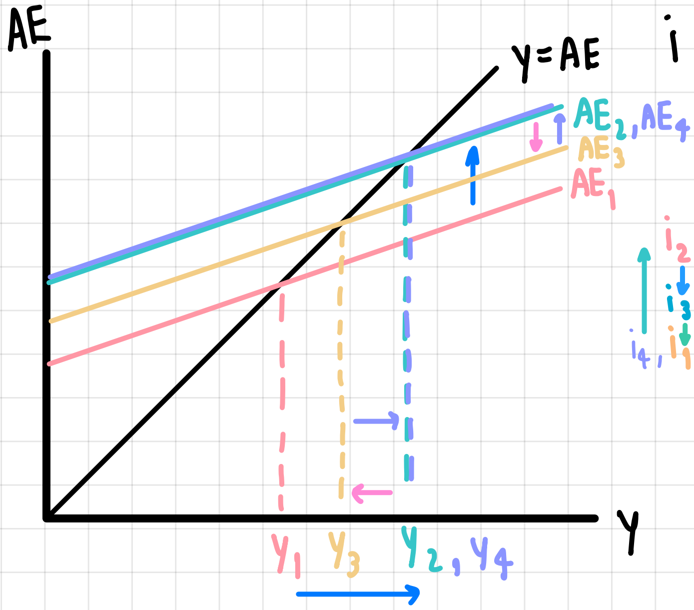
crowding out effect

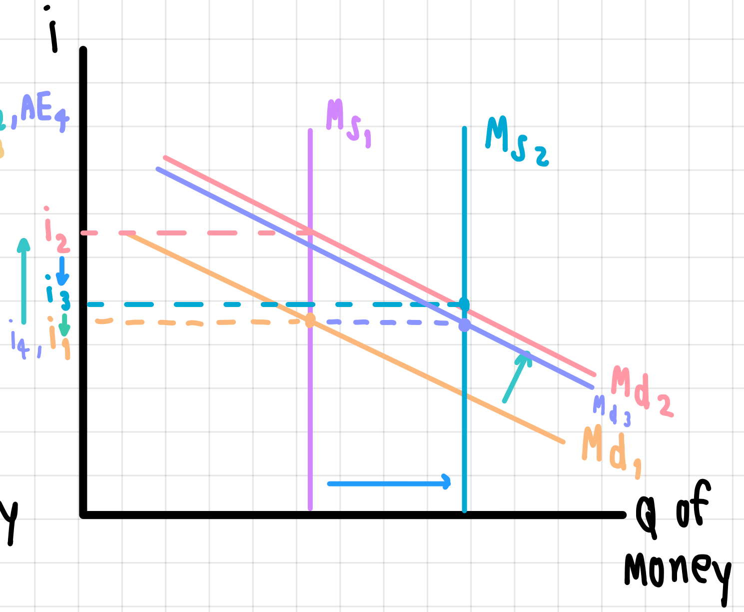


explanation

when the government spending increases, this makes demand in economy (AE) drives up and also output and income (y) drive up too. And then Money demand will be raised because of the increasing in y. when money demand curve increases, the interest rate will raise. The higher interest rate makes the lower investment in private sector (crowding-out effect) and then the demand in economy (AE) and income and output (y) will decrease because of higher interest rate.

b.)





(expansionary fiscal policy)

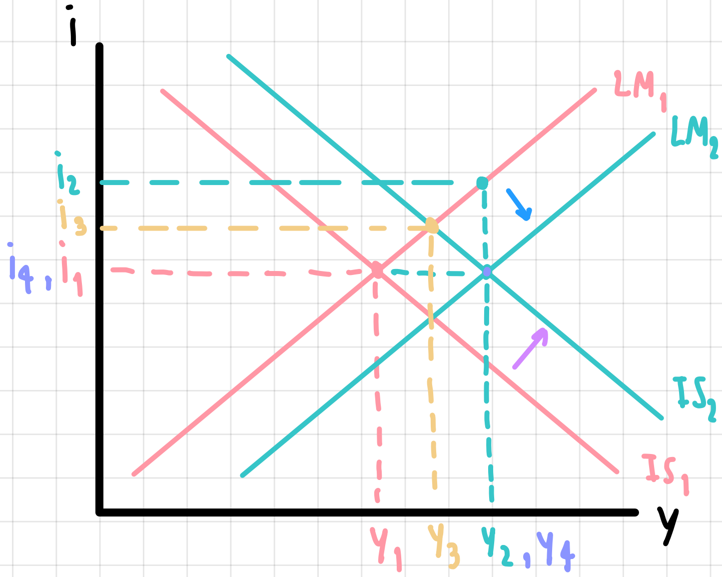
1.) GM : $G\uparrow \rightarrow AE\uparrow \rightarrow Y\uparrow$

2.) MM : $Y\uparrow \rightarrow M_d\uparrow \rightarrow i\uparrow$

3.) GM : $i\uparrow \rightarrow I\downarrow \rightarrow AE\downarrow \rightarrow Y\downarrow$

4.) MM : $M_s\uparrow \rightarrow i\downarrow$ (expansionary monetary policy)

5.) GM : $i\downarrow \rightarrow I\uparrow \rightarrow AE\uparrow \rightarrow Y\uparrow$



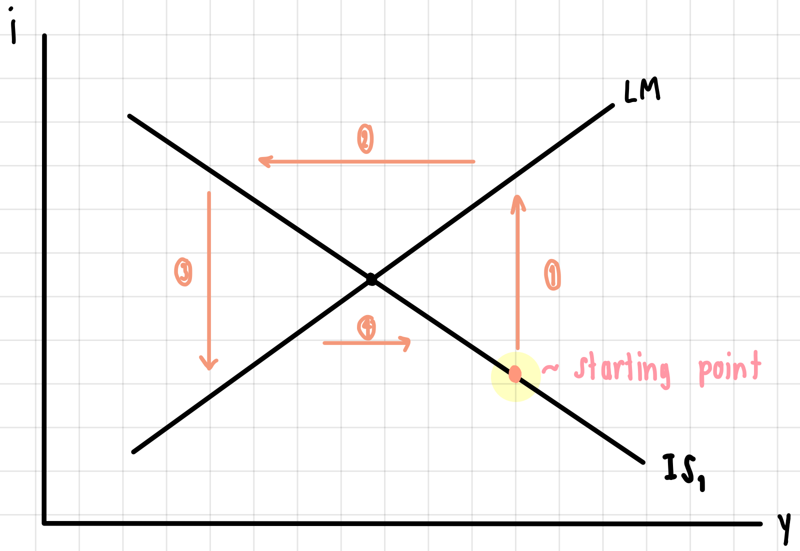
Explaination

To avoid crowding-out effect, the government have to achieve both policy fiscal & monetary policy. starting with the government spending increases, this makes demand in economy (AE) drives up and also output and income (y) drive up too. And then money demand will be raised because of the increasing in y. when money demand curve increases, the interest rate will raise. Then income and output (y) return to decrease. When the central bank use expansionary monetary policy, its reduces interest rate for increasing money supply. Finally in good and service market, when lower interest rate, it makes investment (I) and demand in economy (AE) and also income and output increase.

Question 2

Draw the IS-LM diagram. **Pick ANY point on either the IS curve or the LM curve** (NOT the general equilibrium point). ย้ำว่าเลือกจุดไหนก็ได้ที่อยู่บนเส้น IS **หรือ** LM **ที่ไม่ใช่จุดตัดตรงกลางของสองกราฟ**

Use the diagram that you draw to briefly explain how the two markets at **your current point** will adjust towards the general equilibrium.



Explaination

The starting point is on IS curve which means that in good & service market get into equilibrium so we have to adjust equilibrium in money market (LM curve). From starting point, it stays below LM curve so the interest rate should be increase. The higher interest rate makes lower investment (I) and output and income (y) in Good & service market. And then when output and income (y) decline, Money demand will decrease and interest rate will decrease too. Eventually, when interest rate decreases, it leads to higher investment (I) and higher output and income in good & service market. In consequence, the point which I choose will adjust toward the general equilibrium.

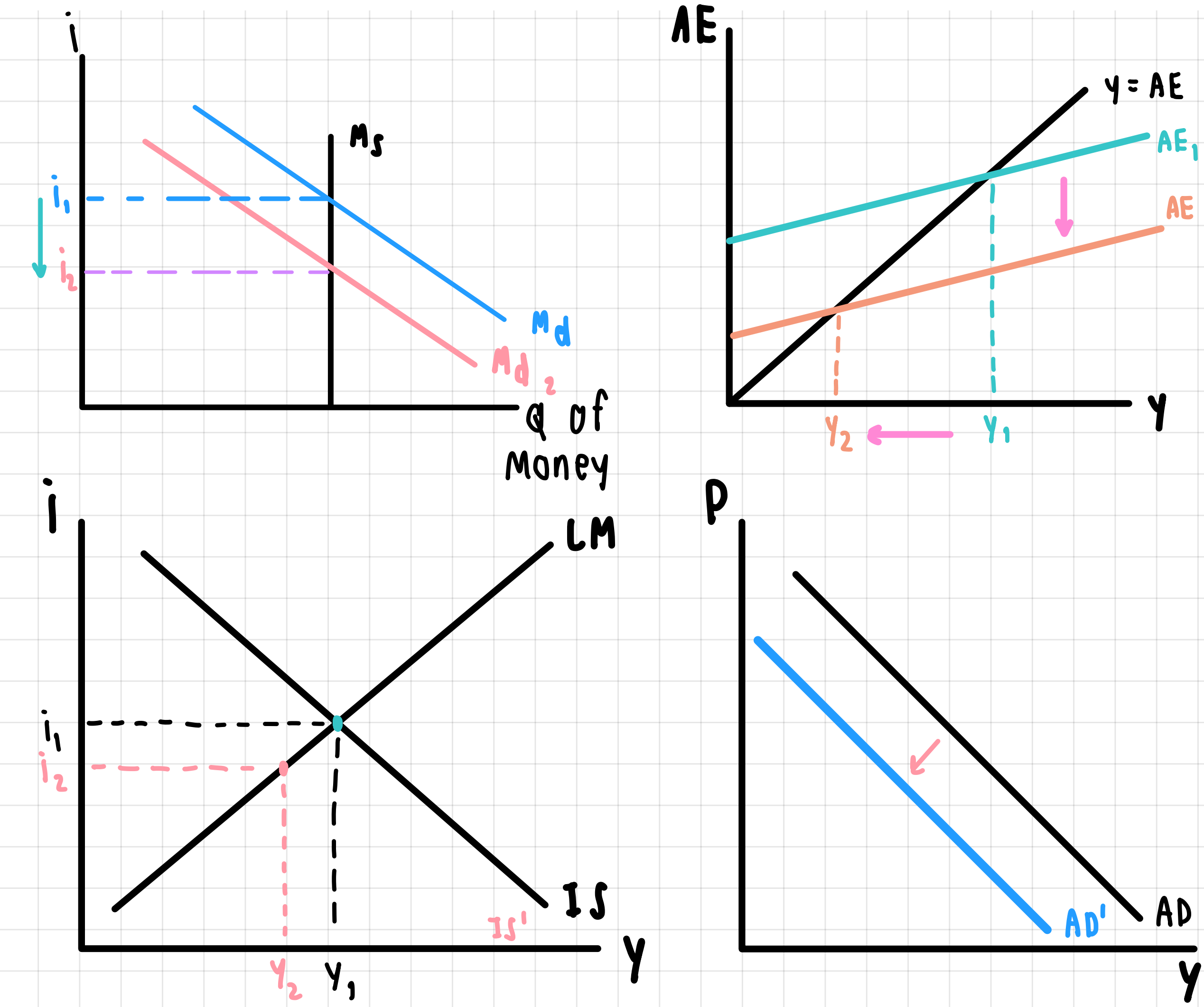
Question 3

Assume that the liquidity preference function (real money demand) is given by the $L(Y, i) = L_0 + L_Y Y - L_i i$.

Note that **L_0 is autonomous money demand**, while other terms are the same as in the lecture slides.

Now suppose that L_0 falls.

a. Give ONE reason why this may happen.
b. Show and briefly explain the effect of the fall in L_0 on the 4 diagrams (Keynesian Cross, Money Market, IS-LM, AD).



a.) when L_0 falls, the other variable will fall too. It makes money demand decrease.

b.) when the money demand decreases, the interest rate will falls in money market. And in Good and service market, the AE will shift down, it makes output decrease. when change in y, it makes movement along the curve in LM curve. Then AD curve will shift down.