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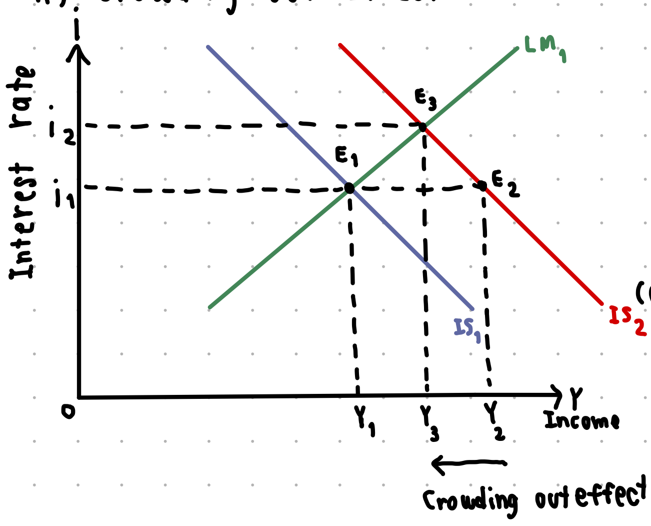
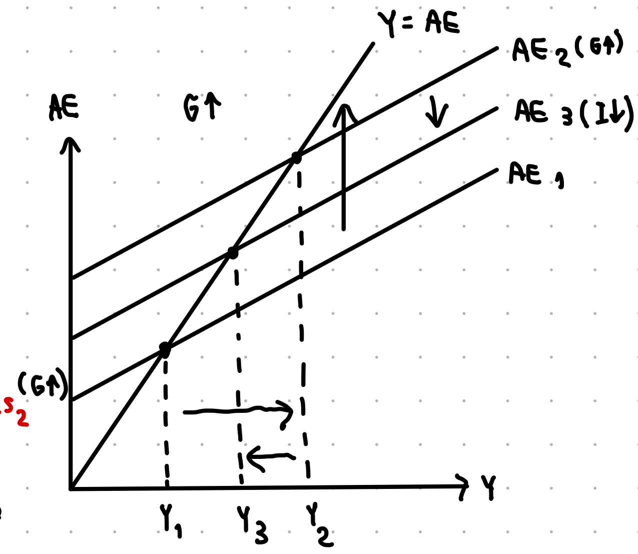
Question 1

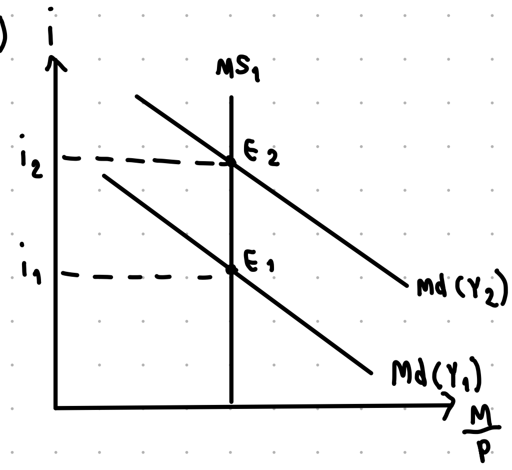
A) crowding Out Effect



Goods market



Money market



Good market $G\uparrow \rightarrow AE\uparrow (AE_1 \rightarrow AE_2) \rightarrow Y\uparrow (Y_1 \rightarrow Y_2)$

Money market $Y\uparrow \rightarrow Md\uparrow \rightarrow i\uparrow$

When G increase, Y_1 increases to Y_2 at E_2.

However, because of higher i at E_3,

investment falls. As a result, Y_2 decrease to Y_3

b) Monatary policy can be used to eliminate crowding out effect

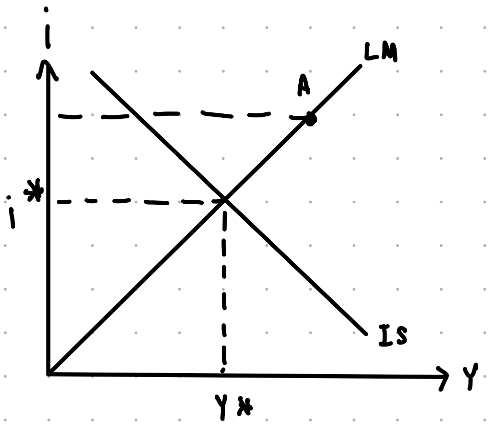
Expansionary monetary Policy : when $M\uparrow$

money market : $M\uparrow \rightarrow i\downarrow$

Goods market : $i\downarrow \rightarrow I\uparrow \rightarrow AE\uparrow \; Y\uparrow$

So the output will be higher and lower interest rate

Question 2



At A, There is excess supply in money market.

where i is high, Bond price is cheaper.

Demand for money for speculation is low because

the opportunity cost for holding money is high

when i is high.

People buy more bonds for speculative purpose.

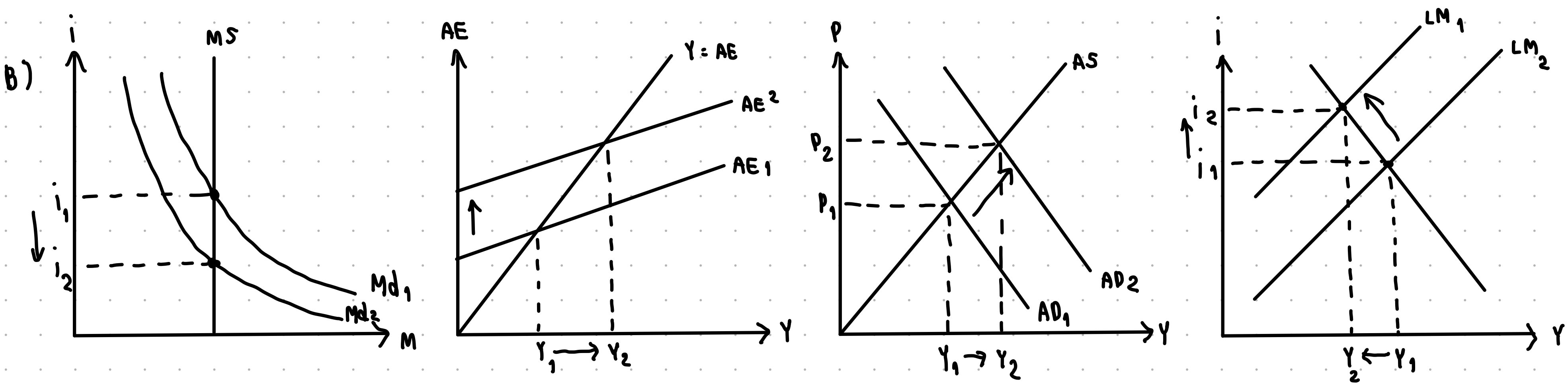
i adjusts to equilibrium $(i\downarrow)$.

Question 3

A) Lower liqvidity means demand for cash decrease.

This may be because of drop in price level.

B)



- Liqvitity ↓ $(Md_1 \rightarrow Md_2) \rightarrow (i_1 \rightarrow i_2)$
- $i\downarrow \rightarrow$ investment $\uparrow \rightarrow AE\uparrow \rightarrow Y\uparrow$
- $AE\uparrow \rightarrow AD\uparrow$
- $P\uparrow \rightarrow$ LM shift to the left