

Lecture 7: IS-LM

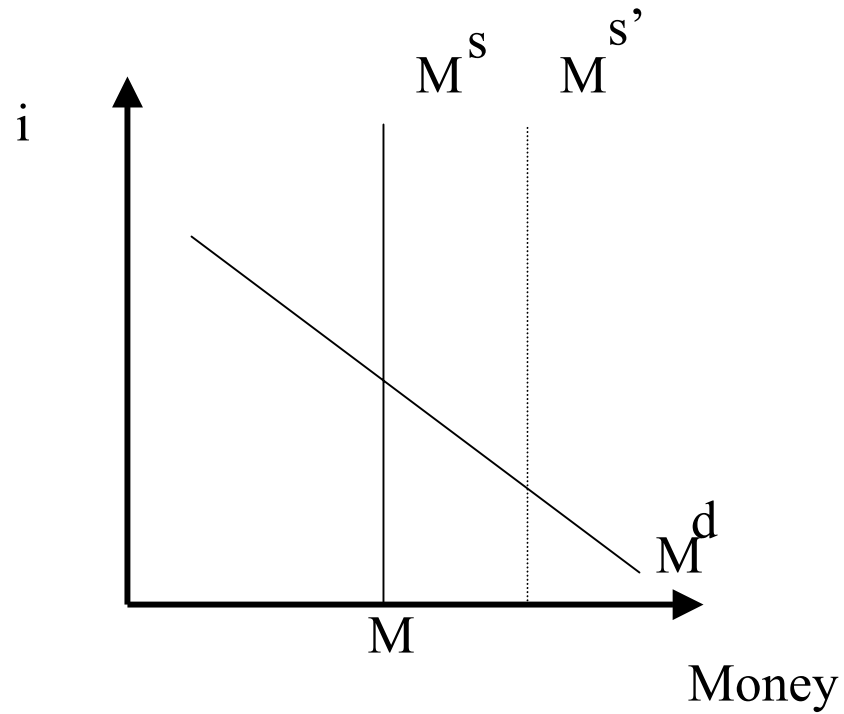
- Find equilibrium in goods and financial markets

\Rightarrow

Determine Y and i

Monetary and fiscal policy

Monetary Policy



Equilibrium Interest Rate

$$\begin{aligned}M_d &= P Y L(i) \\CU_d &= c M_d \\D_d &= (1-c) M_d\end{aligned}$$

$$\begin{aligned}R &= \theta D \\ \Rightarrow \\ R_d &= \theta (1-c) M_d\end{aligned}$$

$$\begin{aligned}H &= CU_d + R_d \quad (\text{supply CB} = \text{demand CB}) \\ H &= [c + \theta (1-c)] M_d \\ H &= [c + \theta (1-c)] P Y L(i)\end{aligned}$$

Equilibrium in M rather than Central Bank M

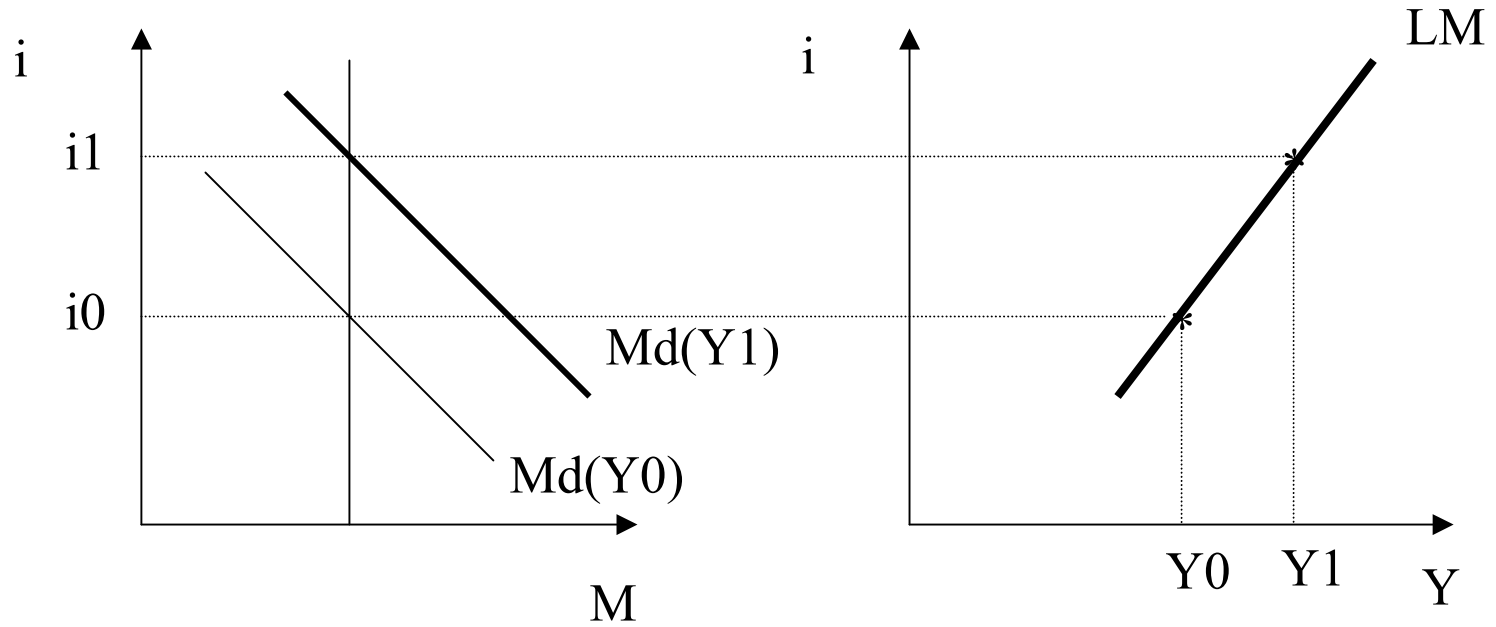
$$M_s = \frac{H}{c + \theta(1-c)}$$

$$M_s = M_d \Rightarrow$$

$$\frac{H}{c + \theta(1-c)} = P Y L(i)$$

Examples: a) Y2k ; b) Prudence; c) OMO with multiplier

LM



A) Expansionary Monetary Policy; B) Y2k

IS

$$\text{OLD: } Y = C(Y-T) + I + G$$

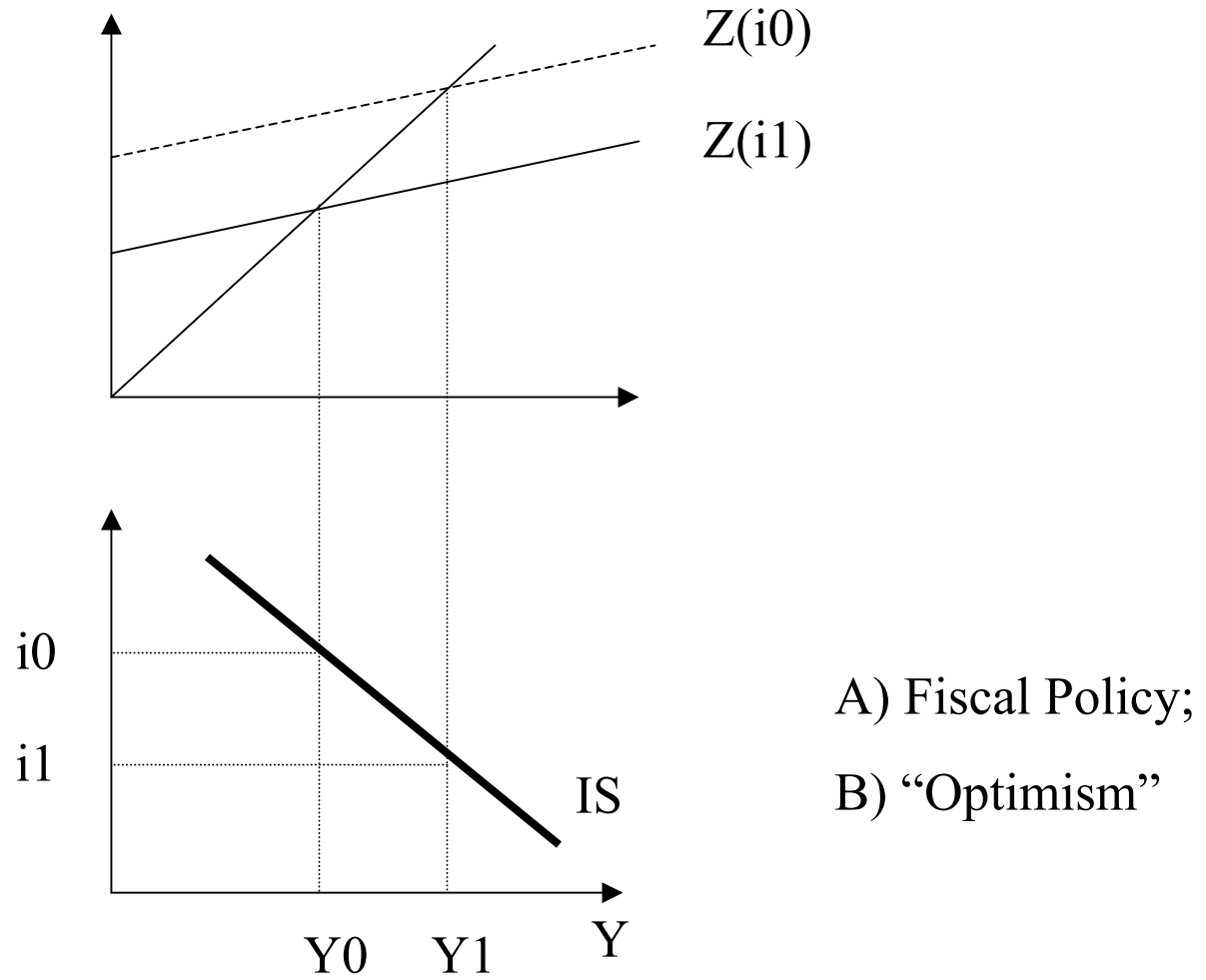
$$I = I(Y,i)$$

+ -

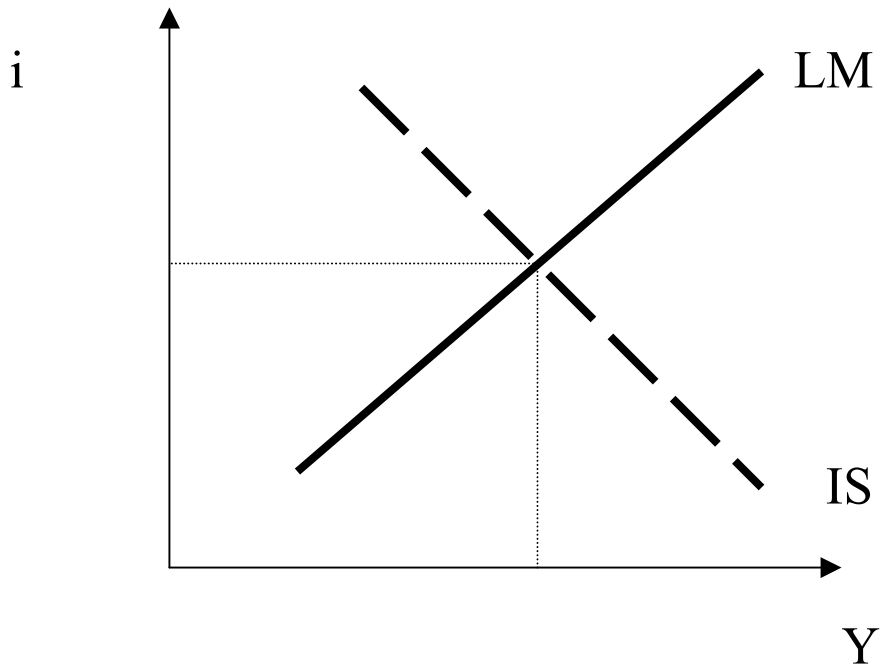
$$\text{IS: } Y = C(Y-T) + I(Y,i) + G$$

Why IS?

IS



IS-LM Model



A) Fiscal policy; B) Monetary policy; C) Mix