Money demand

Finance

These years were characterized by a great recession due to a fall in demand for goods hence failure in the stocks to pick favorable prices. The peak in 2000 and 2007 represents a boom in the economy while the troughs of 2002-2003 and in between 2008-2009 characterizes a great recession.

National savings= Y- Cd-G= Id

Sd= Y-(4000-4000r+0. 2Y)-2000

= Y-4000+4000r-0. 2Y-2000

= 0. 8Y+4000r-6000

b) For the goods market to be cleared, it means that consumption and income equalize; Id= 0

Sd= 0

0. 8Y+4000r-6000= 0

0. 8(10000)+4000r-6000= 0

8000= 6000-4000r

2000= 4000r

r= 0. 5%

When Y = 12, 000

0. 8(12000)+4000r-6000= 0

9, 600= 6000-4000r

3600= 4000r

r= 0. 8%

An increase in income shifts the IS curve to the right.

d) When the government purchases increase to 2400, then the national savings will reduce

Sd= Y-(4000-4000r+0. 2Y)-2400

0= 10000-(4000-4000r+0. 2Y)-2400

0= 10000-4000+4000r-8000-2400

0= 4000r-4400

r= 1. 1%

The IS curve shifts to the right since the interest rates are increased. Again, an increase in government purchases reduces disposable national income hence shifting the IS curve to the left.

3. Real Money Demand and Supply

The real interest rate where

MV= PQ

Md=(3000+0. 1Y-10000i)P*0. 02

For the asset market to clear, money demanded should equal money supplied. Therefore,

Md= Ms= 6000= [3000+0. 1(8000)-10000i) 2* where r= (i+π) hence i= r- π (Fischer's Model)

6000= (3000+800-10000(r-0. 02)]*2

6000= (3800-10000r+200)*2