

Macroeconomics 2

Moodle blocks 9



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# Fiscal and Monetary Policy in the IS - LM Model

1. What do you know about types of monetary and fiscal policies?
2. What are built-in (automatic) stabilizers?
3. Explain when MONETARY policy is inefficient in the IS-LM model. (graphically illustrate)
4. Explain when the FISCAL policy is inefficient in the IS-LM model. (graphically illustrate)
5. Using the IS-LM model, express how the equilibrium income, interest rate, and describe the adjustment process will change: a reduction in the money supply leads to an increase in the budget deficit.
6. Economic data are

C = 50 +0.8 YD I = 300 - 1000 i L = 0.5Y - 5000 i TRa = 100 TAa = 0

G = 350 t = 0.25 M / P = 400

Calculate:

1) the amount of the equilibrium income and the interest rate.

2) the value of the fiscal and monetary policy multiplier

3) Equity income through fiscal and monetary policy multipliers

4) How does the equilibrium NH product change if the autonomous component of investment due to pessimistic investors' expectations drops by 30 and illustrate it graphically

5) how it would have to change the money offer to bring the income back to its equilibrium level and illustrate it graphically.

1. Use the following table to figure out the example

|  |  |
| --- | --- |
| **Sensitivity of demand for money to interest rate** | h = 2000 |
| **Sensitivity of demand for money for income** | k =0,2 |
| **Sensitivity of demand for investment to interest rate** | b = 400 |
| Marginal Propensity to consumption | c = 0,8 |
| Taxation Rate | t= 0,2 |
| Offer of real money balances | M/P = 500 |
| Government expenditures | Ga = 600 |
| Autonomous consumption | Ca = 200 |
| Autonomous investment | Ia = 300 |
| Tra, TAa | 0 |

**Calculate:**

a) the Y-equilibrium income level and the interest rate

b) if the pension Y = 2800, what is the interest rate

c) change the product by increasing government spending by 100, specify a new size Y and i

d) graphically describe the previous situation in the IS-LM model

e) Based on the previous task c) determine the size of the displacement effect of government expenditures

f) Exit from b) to determine the change of product due to a reduction in the real money supply by 100

1. Graphically illustrate the IS - LM model where the sensitivity of investment to interest rates is infinite. Which of the economic policies will be effective for the Nh product (Y).

1. Find the solution in the following table:

|  |  |
| --- | --- |
| Sensitivity of demand for money to interest rate | h = 10000 |
| Sensitivity of demand for money for income | k = 1 |
| Sensitivity of demand for investment to interest rate | b= 1000 |
| Marginal Propensity to consumption | c = 0,6 |
| Taxation rate | t= 0,28 |
| Offer of real money balances | M/P = 900 |
| Equilibrium NH product | 1631,7 |
| Autonomous expenditures | Aa3 = 1000 |

a) calculate the value of the fiscal policy multiplier c

b) Calculate the value of the monetary policy multiplier b

c) How does the equilibrium NH product change if the autonomous component of investment due to pessimistic investor expectations decreases by 100 and illustrate it graphically

d) how it would have to change the offer of money to bring the pension back to Its equilibrium level and illustrate it graphically

1. The economy is described by the following relationships

C = 100 + 0.8 Yd t = 0.25 G = 700 I = 900-5000 \*I M / P = 500 L = 0.25Y - 6250i Tra, TAa = 0

Calculate

A. Equilibrium product and interest rate

B. The government has raised government spending by 35 units in the following year. Find out what change expansive fiscal policy has brought about in consumption

C. Find the value of the displacement effect of the NH product

D. Determine what changes will result in an expansive monetary policy, reducing the money supply by 25 units.