IS-LM Model
Goods Market equilibrium: IS

• AD = C + I + G + NX
• Equilibrium—Y = AD
  \[ Y = C + I + G + NX \]
• In 2-dimension, Y =C + I = C + S
  \[ I = S \]
• S → Y (directly), I → r (inversely)
• Slope of IS curve—negatively sloped (downward sloping)
Shift in IS Curve

• Change in autonomous spending—
  • Changes in government spending
  • Change in taxes
  • Autonomous change in investment
  • Transfer payments
Money Market Equilibrium: LM curve

- $M_d = L(Y, r)$
  - $M_d$ depends inversely with $r$ and directly with $Y$
  - $M_d$ is downward sloping

- $M_s$ is controlled by the central bank of the country –
  - constant at given time
  - Vertical curve

- LM curve is the locus of pair of interest rates and levels of income which are compatible with money market.

- Any point to the right of the LM curve there is an excess demand for money and at any point to the left there is an excess supply of money.

- Slope of LM—positively sloped (Upward sloping)
Shift in the LM Curve

• Changes in the money supply
• Shifts in the money demand function
Monetary policy—Money Influences—Shift in LM curve

- Effects of Changes in Money Supply
  - Keynesian Case—partially effective
  - Liquidity Trap—not effective
  - Classical Case—maximum effect

- Effects of Shift in Money Demand Function
  - Increase in money demand (portfolio shifts away from bonds into money)—Y decline
  - Same effect as a decline in the quantity of money
Fiscal Policy—Real Influences—Shift in IS curve

- Fiscal policy is the instrument of the government to achieve a number of socio-economic objectives.
- It can influence production, consumption and resource allocation.
- Main Instruments of Fiscal Policy
  - Taxation
  - Public expenditure
  - Public Debt
  - Deficit financing