

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point on the assignment.

Note that the original derivation of the IS curve involved setting $S = I$. The book mentions both it and the method using the Keynesian Cross (45° diagram). Mathematically, they are identical. Since the latter is easier to understand, we will concentrate on it.

- 1) (25 points) Illustrate on the IS/LM diagram an increase in the money supply. Explain why the curve(s) moved as drawn.
- 2) (50 points) Illustrate on the IS/LM diagram, Keynesian Cross (45° diagram), and the money supply/money demand diagram, an increase in the marginal propensity to consume. Explain why the curve(s) moved as drawn.
- 3) (15 points) Three components of GDP (C, I, G, X, and M) depend upon the interest rate. Explain how they depend upon the interest rate.
- 4) (10 points) Why does the LM curve slope up?