HW #10 Answer Key

1. i) Loanable Funds

The supply of loanable funds increases, which lowers the interest rate and increases the quantity of loans (investment)

ii) Keynesian Cross

Because investment rose (part (i)), planned spending rises (from PS0 to PS1). Through the multiplier, this raises GDP (income) from Y0 to Y1.

iii) Aggregate demand, aggregate supply

The additional income (from (ii)) raises aggregate demand, which will lead to higher output and prices (depending on the slope of the AS curve).
2. i) Loanable Funds

The supply of loanable funds decreases, which raises the interest rate and decreases the quantity of loans (investment)

ii) Keynesian Cross

Because investment fell (part (i)), planned spending falls (from PS0 to PS1). Through the multiplier, this lowers GDP (income) from Y0 to Y1.

iii) Aggregate demand, aggregate supply

The fall in income (from (ii)) lowers aggregate demand, which will lead to lower output and prices (depending on the slope of the AS curve).
3. i) Loanable Funds

The supply of loanable funds increases, which lowers the interest rate and increases the quantity of loans (investment)

ii) Keynesian Cross

Because investment rose (part (i)), planned spending rises (from PS0 to PS1). Through the multiplier, this raises GDP (income) from Y0 to Y1.

iii) Aggregate demand, aggregate supply

The additional income (from (iii)) raises aggregate demand, which will lead to higher output and prices (depending on the slope of the AS curve).
4. i) Loanable Funds

The supply of loanable funds decreases, which raises the interest rate and decreases the quantity of loans (investment)

ii) Keynesian Cross

Because investment fell (part (i)), planned spending falls (from PS0 to PS1). Through the multiplier, this lowers GDP (income) from Y0 to Y1.

iii) Aggregate demand, aggregate supply

The fall in income (from (ii)) lowers aggregate demand, which will lead to lower output and prices (depending on the slope of the AS curve).