$IS - LM\ MODEL$

$Keynes\ and\ Money\ Market$

<u>Great Depression (1930-31)</u>

<u>Economic Resilience:</u> Demographic Dividend

Multiplier Process: When govt increase spending= Demand increase= Income will increase = Demand increase..........

Virtuous Cycle:

Role of State:

Classical Theory: Maintaining Law and Order, Defence
Keynesian Theory: **Economic Activity**, Government as an important "Economic Entity" (Maintaining Law and Order, Defence)
Government:
1) Monetary Policy (RBI) : IS-LM MODEL /THEORY
2. Fiscal Policy (Ministry of Finance, through "Budget Allocation") = KEYNESIAN THEORY

1. Development of Money Market
2. Development of Capital Market

$$Aggregate\ Demand\ (AD) = Aggregate\ Supply\ (AS)$$

C + I (r) + G + (X - M) = Y

Or, Y = C(Y) + I (r) + G (T) + (X -M) (Balance of Trade: BOT)

Now, I (r) is an inverse function

i.e i) 'r' increases: 'I' decreases
Ii) 'r' decreases: 'I' increases

according to Keynes, 'r' is determined by money market equilibrium by the demand for and supply of money.

In Keynes’ model, changes in the rate of interest happen either due to a change in money supply or a change in demand for money

This in turn will affect the determination of national income and output in the goods market through causing changes in the level of investment.

In this way changes in money market equilibrium influence the determination of national income and output in the goods market.

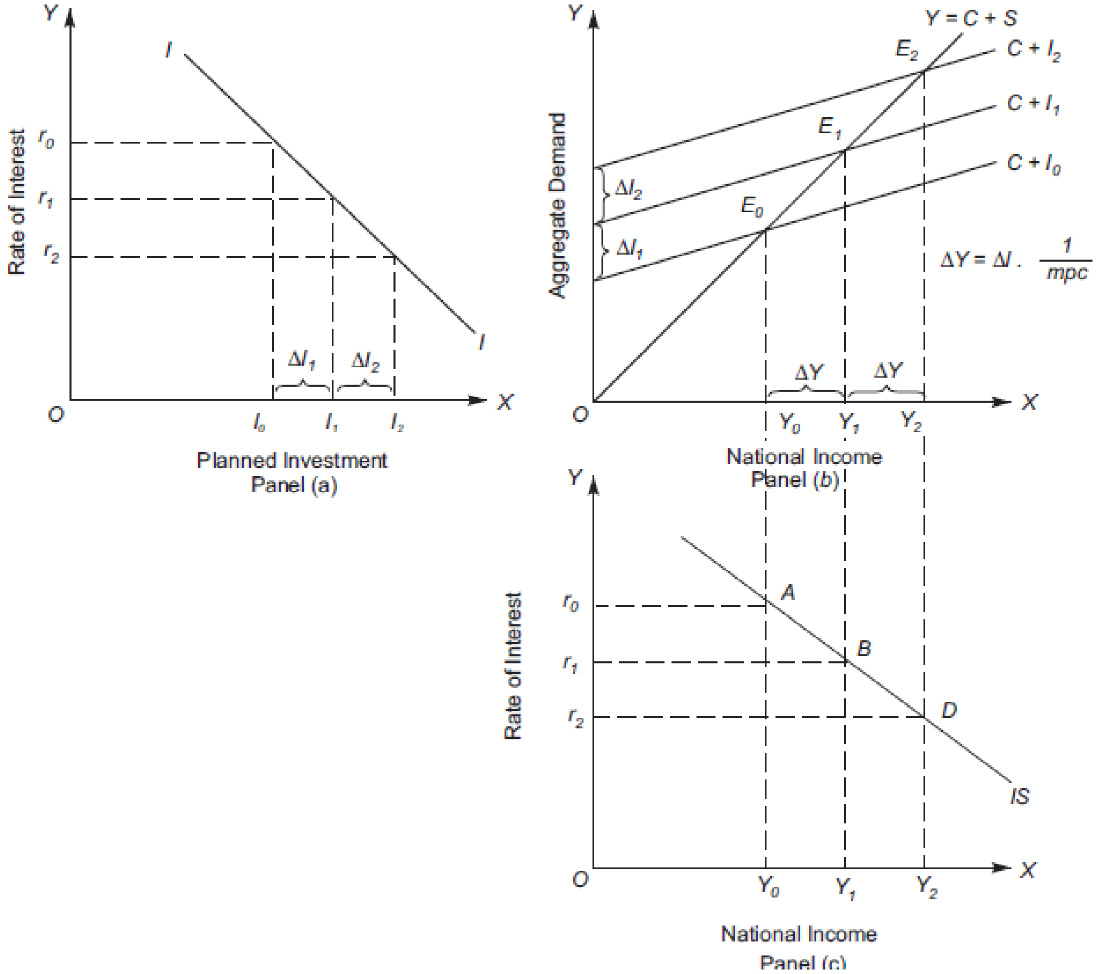
Hicks, Hansen, Lerner, and Johnson have put forward a complete and integrated model based on the Keynesian framework wherein the variables such as **investment, national income, rate of interest, and demand for and supply of money** are interrelated and mutually interdependent and can be represented by the two curves called the **IS and LM curves.**

MONEY MARKET EQUILIBRIUM: DERIVATION OF LM CURVE

In the derivation of the IS curve, we seek to find out the equilibrium level of national income as determined by the equilibrium in the goods market by a **level of investment** determined by a given **rate of interest.**

Thus IS curve relates different equilibrium levels of national income with various rates of interest.

When, 'r' decreases = 'I' increases = (C+I) increases = AD increases = Higher level of market equilibrium = Higher level of NI



MONEY MARKET EQUILIBRIUM : DERIVATION OF LM CURVE

Demand for money to hold depends upon **transaction motive** and **speculative motive**.