Assignment 7

# An ISMP Model

Consider the following economy

## Basic Equilibrium

1. Identify the meaning of each variable.
2. Derive the IS curve.
3. Derive the MP curve
4. Solve for equilibrium

## Comparative statics

Suppose there is a collapse in autonomous consumption, such that it falls from to .

1. Sketch an IS-MP model (don’t worry about labeling intercepts or getting the slope right - just do a rough sketch) and show this change.
2. Calculate the new equilibrium level and the output gap, assuming that the equilibrium in 4 was potential output.
3. How should the Federal Reserve respond to close the output gap? (calculate)
4. Sketch the Federal Reserve’s response in a graph.