[Frequently Asked Questions]

IS-LM Curve - II

Subject:	Business Economics
Course:	B. A. (Hons.), 3rd Semester, Undergraduate
Paper No. & Title:	Paper – 301 Macroeconomics - I
Unit No. & Title:	Unit – 2 IS-LM MODEL
Lecture No. & Title:	Lecture – 2 IS-LM Curve - II

Frequently Asked Questions

Q1. The IS-LM model is based on?

A1.

- Investment demand function.
- The consumption function.
- The demand for money function.
- The quantity of money.

Q2. What are the factors responsible for the shift in the IS-LM curve?

A2.

- The saving and the investment.
- The productivity of capital.
- The propensity to consume and save.
- Demand for money.
- Supply of money.

Q3. The IS-LM curve are related to which variables?

A3. The IS-LM curve are related to 2 variables namely income & ROI. The IS-LM curves combines through the determinants of the interest rate & the income level and provides the equilibrium point while they interest each other.

Q4. What are the various causes of shift in IS Curve?

A4. The autonomous investment, government expenditure and desire to save reduces the propensity to consume hence effects the movement in IS-curve. Thus, shifts in IS curve is realised.

Q5. What causes the rate of interest to fall?

A5. According to the Liquidity preference schedule with the increase in money supply more money is available for the speculative purpose at a given level of income. This causes the rate of interest to fall and LM curve shifts to the right.

Q6. State two limitations of IS-LM curve.

A6. The two limitations of IS-LM curve are as follows:

a) **Interest rate not flexible:** The theory is based on the assumption that the interest is flexible and varies with changes in LM and IS.

b) **Investment is not interest elastic:** The theory assumes that investment is interest elastic but in actual it is not.

Q7. Explain the shift in LM curve due to changes in Money or Liquidity Preference.

A7. Changes in demand for money bring changes in LM curve. If there is increase in demand for money or liquidity preference then the LM curve will shift towards left. This happens due to higher demand for money, given supply of money, will raise the rate of interest corresponding to each level of income.

Q8. Explain the shift in IS – curve due to changes in autonomous investment and government expenditure.

A8. The changes in autonomous investment and government expenditure is also a cause of shift in IS curve. If there is increase in autonomous investment and government expenditure then the aggregate demand for goods will increase and this brings increase in National Income through the multiplier process given by Keynes.

Q9. Explain the shift in LM-curve due to changes in Supply of money on ROI and Income level.

A9. When the monetary authorities increase the supply of money, more money will be available for speculative motive at a given level of income. Hence we will observe fall in ROI. As a result, LM cure will shift to right and level of income will increase.

Q10. Why is the supply of money a vertical straight line?

A10. The money supply curve a vertical straight line because in short run the supply of money remains constant.