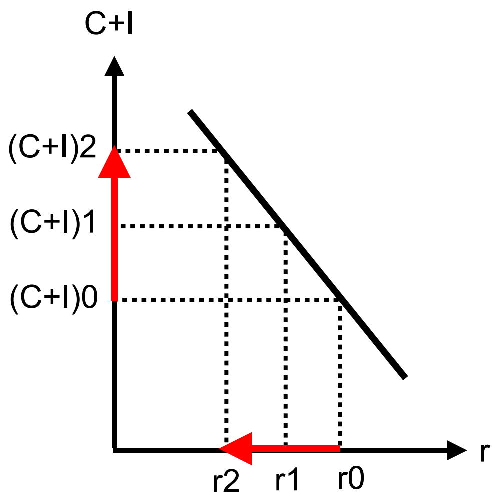
IS-LM Model (derivation)

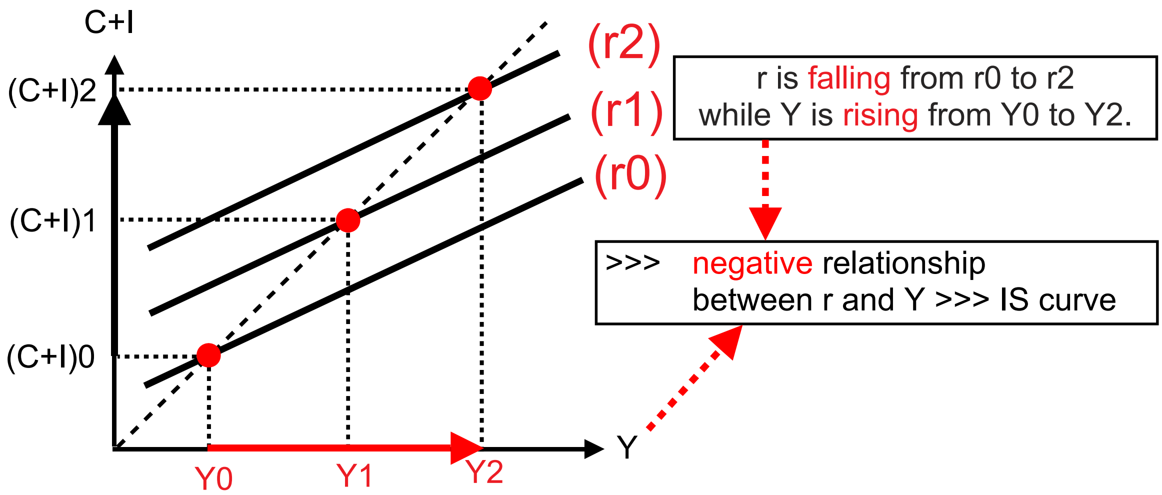
Abbreviations	
r = Interest rate	M = Quantity of money
C = Consumption	MD = Money demand
I = Investment	MS = Money supply
Y = Output, income	

❶ IS: Goods market (two sector-model, households and firms)

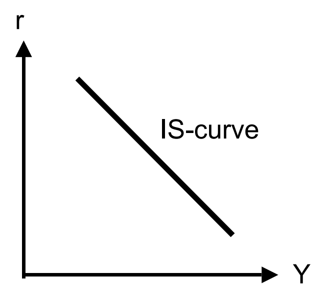
1 If r falls, (C+I) are rising [and if r rises, (C+I) are falling].



2 → Equilibria on the goods market

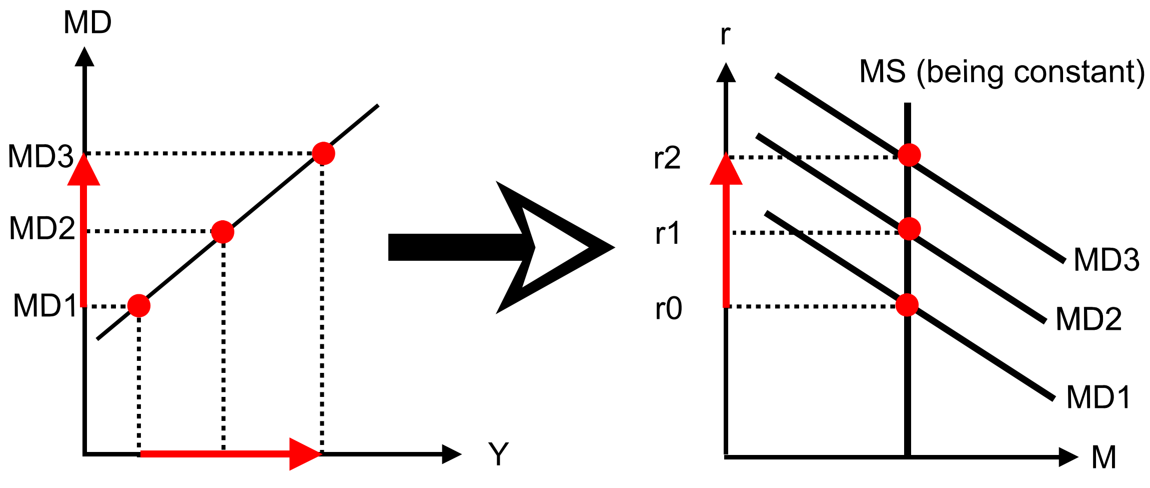


3 → IS curve: Equilibria on the goods market



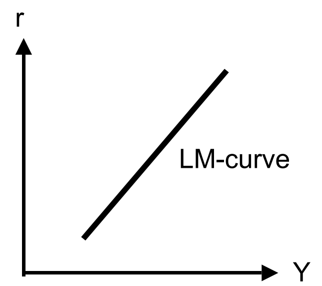
❷ LM: Money market

1 If Y rises, both MD and r are rising (and if Y falls, both MD and r are falling).



>>> positive relationship between r and Y >>> LM curve

2 → LM curve: Equilibria on the money market



❸ IS-LM model: Simultaneous equilibrium on the goods and on the money market