Week 10 Review Session Questions

Thursday, June 5th, 5 and 6pm, North Hall 1110

1. a. Using the money market diagram, the aggregate expenditures diagram and the aggregate demand curve on a third diagram, show how a decrease in the money supply shifts the aggregate demand curve leftward.

b. Using the aggregate expenditures diagram and the aggregate demand curve on a third diagram, show how an increase in government expenditures shifts the aggregate demand curve rightward.

2. a. With an AD and AS diagram only, explain the short-run effects of a decrease in the money supply on real GDP and the price level. Assume the economy begins at full employment.

b. Use an AD and AS graph (and other relevant graphs if needed) to explain the short-run effects on real GDP, the price level and the interest rate of an increase in autonomous consumption spending. Assume the economy begins at full employment.

c. During the 1990s, because of technological change, the AS curve was shifting rightward, but-except for a few months-the price level did not fall. Why not? (Hint: What was the Fed doing?)

3. Draw the economy in a full-employment equilibrium using AS/AD curves.

   a. Show the consequence of a housing market crash in the AS/AD model.
   b. What is the appropriate fiscal policy response to the crash if the government is concerned with achieving full-employment and maintaining stable prices?
   c. What is the appropriate monetary policy response to the crash if the Fed is concerned with achieving full-employment and maintaining stable prices?

4. Draw the economy in a full-employment equilibrium using AS/AD curves.

   a. Show the consequence of an increase in production costs in the AS/AD model.
   b. If the government (or Fed) is concerned with maintaining stable prices, show and discuss how what policies need to be carried out. What is the cost of maintaining stable prices?
   c. If the government (or Fed) is concerned with reaching full-employment, show and discuss how what policies need to be carried out. What is the cost of remaining at the full-employment level of output?