

Econ 102
Aggregate Supply and Demand
Due March 30, 2007

1. As on previous homework assignments, turn in a news article together with your summary and explanation of why it is relevant to this week's topic, "Aggregate Supply and Demand."
2. Consider an economy that starts in a long-run equilibrium with all real and nominal variables both remaining constant over time. The central bank then increases the money supply by 10%, and after that holds it constant at the new higher level.
 - a. First, use what you've learned in this course about the long-run behavior of the economy (including the long-run open-economy model and the quantity theory of money) to determine, once a new long-run equilibrium is reached, how the following variables will compare to what they were in the initial long-run equilibrium? Explain how you get your answers.
 - i. The price level
 - ii. Real GDP
 - iii. The real interest rate
 - iv. The nominal interest rate
 - v. The real exchange rate
 - vi. The nominal exchange rate
 - vii. The trade balance
 - b. Now use the aggregate supply and demand model to determine what it says about the effects of this same increase in the money supply, in both the short run and the long run. Show how you get your answers. Does the AS-AD model disagree, in its implications for the long run, with what you found in part (a)?
3. Suppose that the US economy is initially in long-run equilibrium. For each of the changes listed below, analyze short-run and long-run effects on:
 - i) the equilibrium level of real GDP;
 - ii) the equilibrium level of nominal GDP; and
 - iii) the equilibrium level of unemployment.In each case, draw a diagram and include an explanation as to why the curves shift as they do.
 - a) Consumers, coming to fear that the government will not provide for them in their old age, increase their saving.
 - b) Optimism about future economic performance causes businesses to increase domestic fixed investment.
 - c) In a quest for re-election, the president pushes for more tax cuts.
 - d) An increase in the price of oil used in production.