Econ 102
Short Run Fluctuation: AS/AD
Due April 6, 2007

1. Be sure to read your copy of the Wall Street Journal every weekday, looking especially for items related to the material in this course. Find an article in this week's Wall Street Journal or other news source that is relevant to the topic of this homework assignment. Turn it in, or a copy of it, with your assignment, and write a brief summary of it (half a page to a page). Your summary should outline the main points of the article **and** explain why it is relevant to the homework topic, in this case "short run fluctuations."

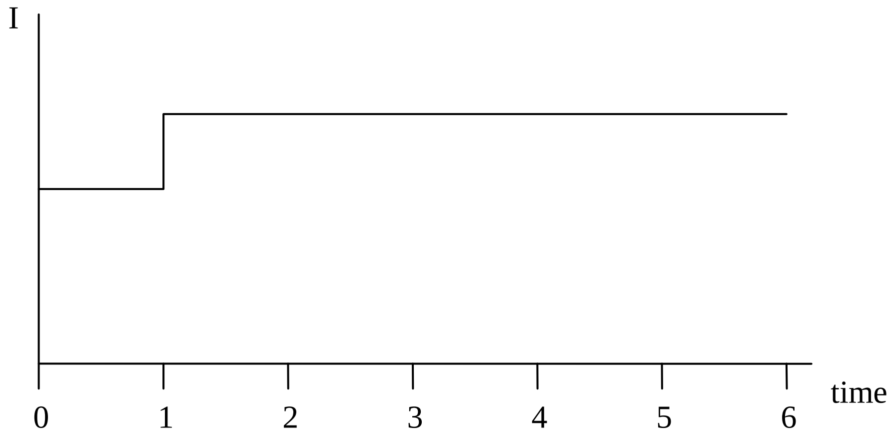
2. Consider an economy that is initially in long run equilibrium. For each of the changes listed below,
   i. Illustrate the short run change using a short run aggregate supply / aggregate demand (AS/AD) diagram.
   ii. Note the short-run change in aggregate price level, real income, and unemployment.
   iii. Illustrate the return to long run equilibrium (assuming that real potential output remains unchanged), and note the final long run impact on the price level.

   a. An increase in the private desire to save, given any real interest rate and price level.
   b. A decrease in the domestic desire to invest in physical capital.
   c. An increase in government purchases of goods.
   d. An increase in firms' expectations about the relative price of their own output compared to others'.

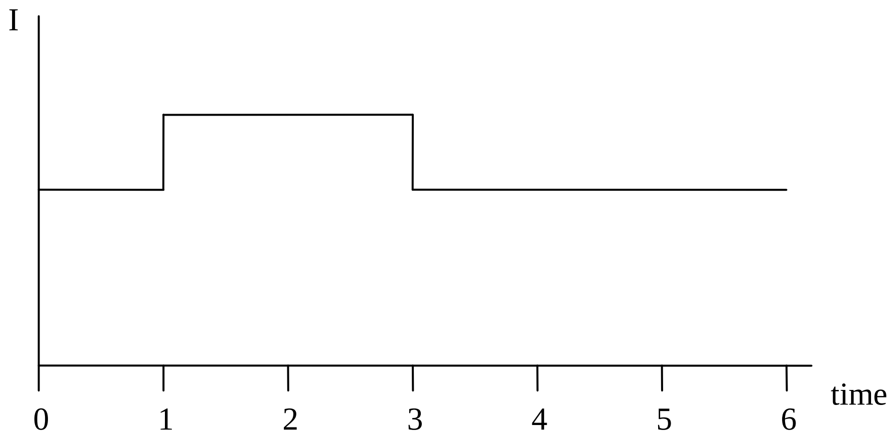
3. Briefly explain the process by which an economy returns to long run equilibrium from a recession in the absence of government involvement.

4. The graphs below show several paths for how investment in an economy might vary over time. Assume that initially the economy was in a long-run equilibrium at the initial level of investment, that other components of aggregate demand remain constant over time, that the natural rate of output does *not* grow (in spite of this investment), and that it takes exactly 2 years for the economy, if otherwise undisturbed, to adjust from a short-run equilibrium (which is reached immediately) to a long-run equilibrium, which it approaches gradually. Based on those assumptions, draw the path over time of real GDP that should correspond to each of these paths for investment.

a)



b)



c)