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| **Exercises from old exams to chapters in B & W with solutions.** |

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| **Chapter 13** |

**Exercise 1**

Answer the following statements as **true** or **false**, and explain why. Write no more than three sentences on each question.

1. An increase in expected prices would shift the aggregate supply curve down.

**Answer:**

**False:** An increase in expected price will increase the nominal wage, which will increase cost and eventually the price charged by firms. Hence, the aggregate supply curve will shift up.

**Exercise 2**

1. What is the Phillips tradeoff?
2. Explain the following; “The Phillips curve has been useful for helping us think about the short run behavior of inflation. At the same time it is unstable and seems to vanish at times.”
3. How can the Phillips curve be transformed into an aggregate supply curve using Okuns law?
4. Define three factors that shifts the Phillips and aggregate supply curve, and explain by using a diagram how these factors shift the curves.

**Answer:**

1. The notion that lower unemployment can be “bought” at the price of a higher rate of inflation.
2. In the short run there is a tradeoff, but there is no example of both no inflation and no unemployment. But sometimes it seems to vanish in the way that there is no trade off. For example, in situations when you get stagflation (both increasing inflation and increasing unemployment).
3. Can be explained by using three diagrams and then going from a Phillips curve via Okuns law (Okuns law implies that, when the economy slows down, unemployment increases; when output rises relative to trend, unemployment declines) to the aggregate supply curve.
4. Underlying inflation (inertial inflation), the output trend (Y gap or U gap) and supply shock (S).

**Exercise 3**

Define the AS curve and explain why the slope is different when moving from the short to the long run.

**Answer:**

AS: Total volume of goods and services brought to market by producers at a given price level. In the short run, an economy can sustain lower unemployment and higher output, but at the cost of higher inflation. This tradeoff is not permanent. When underlying inflation rises to track higher actual inflation, the short run AS curve shifts up.