Practice Problems: Expectations and Policy

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Blanchard / Johnson, Macroeconomics, 6th ed., ch. 16

1 Miscellaneous

1. Explain why expectations of future policies shift the IS curve. Show how this renders persistent monetary policies more effective than transitory ones.

2. Can monetary policy shift the IS curve?

   A: Yes, if it changes expected future interest rates or output. Example: The Fed announces to hold interest rates low until 2014.

3. Explain how a fiscal contraction could be expansionary.

   A: Agents expect lower future interest rates and higher output (more capital). That has positive income effects today.

4. Deficit reduction packages are often "backloaded." Why might this be?

   A: An attempt to get the expansionary effect, while weakening the contractionary effect by introducing it gradually.
