HE2002 Macroeconomics II AY25-26 SEMESTER 2

Tutorial 6

(Please read the Slides Lecture 5: The Labor Market and watch the recording before attempting the following question.)

1. **Chapter 7, Q3. The natural rate of unemployment**

    Suppose that the markup of goods prices over marginal cost is 5%, and that the wage-setting equation is

    $$W = P(1 - u)$$

    where u is the unemployment rate.

    (a) What is the real wage, as determined by the price-setting equation?

    (b) What is the natural rate of unemployment?

    (c) Suppose that the markup of prices over costs increases to 10%. What happens to the natural rate of unemployment? Explain the logic behind your answer.

2. **Chapter 7, Q6. The existence of unemployment**

    (a) Why does the wage-setting relation in the Figure have a downward slope? As employment N approaches labor force L, what happens to the unemployment rate?

    (b) The price-setting relation is horizontal. How would an increase in the mark-up affect the position of the price-setting relation in the Figure? How would an increase in the mark-up affect the natural rate of unemployment in the Figure?

Real wage, W/P

$\dfrac{1}{1+m}$

A

Price-setting relation

PS

WS

Wage-setting relation

u_n

Unemployment rate, u