Economic Fluctuations

Question 1

Suppose the Fed reduces the money supply by 5 percent. Assumer the velocity of money is constant.

a. What happens to the aggregate demand curve?

b. What happens to the level of output and the price level in the short run and in the long run? Give a precise numerical answer.

c. In light of your answer to part (b), what happens to unemployment in the short run and in the long run according to Okun's law? Again give a precise numerical answer.

d. What happens to the real interest rate in the short run and in the long run? (Hint: use the NIAI to determine the effect of when output changes.) Here, your answer should just give the direction of the changes.

Question 2

Let's examine how the goals of the Fed influence its response to shocks. Suppose that in scenario A the Fed cares only about keeping the price level stable and in scenario B the Fed cares only about keeping output and employment at their natural levels. Explain how in each scenario the Fed would respond to the following.

a. An exogenous increase in the velocity of money.

b. An exogenous increase in the price of oil.

Question 3

The official arbiter of when recessions begin and end is the National Bureau of Economic Research, a nonprofit economics research group. Go to the NBER website and list the last four recessions from peak to trough. Are we currently in a period of economic expansion, contraction, or leveling-off?

Question 4

The Clean Air Act Amendments of 1977 significantly improved the federal government's power to control air pollution. In the act, firms within counties out of attainment had to adopt costly pollution abatement technologies significantly increasing the costs of production.

a. Graphically illustrate what happened to short-run aggregate supply as a result of the CAAA of 1977.

b. Further illustrate what happened in the short run to the price level and output. What happened in the long run?

c. Suppose the Fed wanted to maintain output at its original level. What action could the Fed have taken to maintain output? Illustrate the effect of such a policy.