

Recitation 12

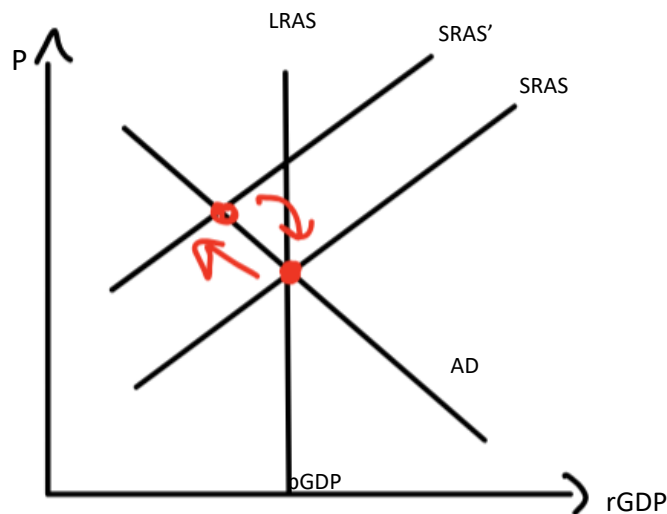
1. Business cycles

- a. Describe what happens to the macroeconomic equilibrium in the short- and the long-run when due to trade restrictions the cost of raw aluminum increases! Illustrate the changes using the AD-AS model, as well!

(1) LRAS curve doesn't change; AD curve doesn't change. Thus, the long run equilibrium remain unchanged.

(2) Production cost $\uparrow \rightarrow$ SRAS shift to the left \rightarrow (cost push inflation) \rightarrow wage $\downarrow \rightarrow$ SRAS shift to the right

Thus, for the short run equilibrium, it shifts up and left firstly (with equilibrium price rise and rGDP fall). Then the model self corrects with wages rise. Short run equilibrium shifts back to the initial equilibrium point.



- b. Describe what happens to the macroeconomic equilibrium in the short- and the long-run when the government introduces a new minimum wage policy and simultaneously enters a trade agreement that boosts net exports! Illustrate the changes using the AD-AS model, as well!

I : minimum wage $\uparrow \rightarrow$ full employment $\downarrow \rightarrow$ pGDP $\downarrow \rightarrow$ LRAS and SRAS shift to the left.

II : To keep price unchanged, $MS \downarrow \rightarrow AD \downarrow$ (shift to the left)

III: $NX \uparrow \rightarrow AD \uparrow \rightarrow P \uparrow \rightarrow$ demand pull inflation

IV: wage $\uparrow \rightarrow$ SRAS shift to the left.

- (1) Long run equilibrium shifts from point 1 to point 4. The long run equilibrium price increases and rGDP or pGDP decreases.
- (2) The short-run equilibrium shifts sequentially from point 1 to point 2, then to point 3, and finally to point 4.

