EC 201: Principles of Macroeconomics

In class exercise 10: AD-AS Model

Spring 2022

Q1.An increase in the aggregate price level causes consumer and investment spending to ...., because consumer purchasing power .... and money demand ....

Q2. Determine whether the following shift AD or SRAS to the left or to the right.

1. Changes in the healthcare market cause employers to pay significantly more for health insurance they provide employees.
2. The production of a new type of blade for their combine harvesters, a tractor used to harvest crops, has allowed wheat farmers, like Herbert, to increase productivity by 40%.
3. The United States government decides to increase the federal tax rate by 4% for all earners.
4. The Federal Reserve, the agency charged with regulating banking and monetary policy in the United States, decides to increase the amount of money available in the economy.

Q3. In a graph, show how an increase in the nominal wages affect economy's output in the long run.

Q4. Would a discovery of new technology that increases productivity shift LRAS? Show it in a graph along with how the equilibrium changes.

Q5. Using the AD-AS model, show the following macroeconomic situations. Why does each of these situations arise?

1. Stagflation
2. Recessionary gap

3. Inflationary gap

Q6. Why do we say that in the long run inflationary and recessionary gaps are self-correcting?

Q7. Using AD, SRAS, and LRAS curves, consider the process by which the following economic events will move the economy from one long-run macroeconomic equilibrium to another. What are the short-run and long-run effects on the aggregate price level and aggregate output of the following?

1. There is a decrease in households' wealth due to a decline in the stock market.

2. There is an increase in government spending.

Q7. What kind of policies should government follow in the following situations?

- Economy is facing a recessionary gap.

- Economy is facing an inflationary gap.

Q8. Assume that economy is at the long run equilibrium. Imagine you are a renowned economist. One day someone asks you which economic shock you would prefer the most and the least. What would you say and why? Can you explain your answers using graphs?