Homework #10: Chapter 14
Aggregate Demand and Aggregate Supply

1. Suppose the economy is in long-run equilibrium. Then, suppose the Federal Reserve suddenly increases the money supply.

a. Describe the initial impact of this event in the model of aggregate demand and aggregate supply by explaining which curve shifts and which way. [2 points]

b. What happens to the price level and real output in the short run? [2 points]

c. If the economy is allowed to adjust to the increase in the money supply, what happens to the price level and real output in the long run (compared to their original levels)? [2 points]

d. Does an increase in the money supply move output above the natural rate indefinitely? Why? [2 points]

Multiple Choice Questions. [1 point each]

2. Which of the following statement about economic fluctuations is true?
   a. A recession is when output rises above the natural rate of output.
   b. A depression is a mild recession.
   c. Economics fluctuations have been terms the “business cycle” because the movements in output are regular and predictable.
   d. A variety of spending, income, and output measures can be used to measure economics fluctuations because most macroeconomic quantities tend to fluctuate together.
   e. none of the above.

3. According to the interest rate effect, aggregate demand slopes downward because
a. lower prices increase the value of money holdings and consumer spending increases.
b. lower prices decrease the value of money holdings and consumer spending decreases.
c. lower prices reduce money holdings, increase lending, interest rates fall, and investment spending increases.
d. lower prices increase money holdings, decrease lending, interest rates rise, and investment spending falls.

4. Which of the following would not cause a shift in the long-run aggregate supply curve?
   a. an increase in available labor
   b. an increase in available capital
   c. an increase in available technology
   d. an increase in price expectations
   e. All of the above shift the long-run aggregate supply curve.

5. Which of the following is not a reason why the aggregate-demand curve slopes downward?
   a. the wealth effect
   b. the interest-rate effect
   c. the classical dichotomy / money neutrality effects
   d. the exchange-rate effect
   e. All of the above are reasons why the AD curve slopes downward.

6. In the model of AD and AS, the initial impact of an increase in consumer optimism is to
   a. shift SRAS right.
   b. shift SRAS left.
   c. shift AD right.
   d. shift AD left.
   e. shift LRAS left.

7. Which of the following statements is true regarding the LRAS curve? The LRAS curve
   a. shifts left when the natural rate of unemployment falls.
   b. is vertical because an equal change in all nominal prices and wages leaves output unaffected.
   c. is positively sloped because price expectations and wages tend to be fixed in the long run.
   d. shift right when the government raises the minimum wage.

8. According to the wealth effect, AD slopes downward because
   a. lower prices increase the value of money holdings and consumer spending increases.
   b. lower prices decrease the value of money holdings and consumer spending decreases.
   c. lower prices reduce money holdings, increase lending, interest rates fall, and investment spending increases.
   d. lower prices increase money holdings, decrease lending, interest rates rise, and investment spending falls.

9. The natural rate of output is the amount of real GDP produced
   a. when there is no unemployment
   b. when the economy is at the natural rate of investment.
   c. when the economy is at the natural rate of aggregate demand.
   d. when the economy is at the natural rate of unemployment.

10. Suppose the price level falls but suppliers only notice that the price of their particular product has fallen. Thinking there has been a fall in the relative price of their product, they cut back on production. This is a demonstration of the
a. misperceptions theory of the SRAS curve.
b. sticky-wage theory of the SRAS curve.
c. sticky-price theory of the SRAS curve.
d. classical dichotomy of the SRAS curve.

11. Stagflation occurs when the economy experiences
a. falling prices and falling output.
b. falling prices and rising output.
c. rising prices and rising output.
d. rising prices and falling output.

12. Which of the following events shifts the SRAS curve to the right?
a. an increase in government spending on military equipment
b. an increase in price expectations
c. a drop in oil prices
d. a decrease in the money supply
e. none of the above.

Use the following exhibit to answer question 13.

13. Suppose the economy is operating in a recession such as point B in the graph above. If policymakers wished to move output to its long-run natural rate, they should attempt to
a. shift aggregate demand to the right
b. shift aggregate demand to the left
c. shift SRAS to the right
d. shift SRAS to the left