Chapter 11 textbook problems KEY

11-2 a. increase: desired investment increases; equilibrium increases; interest rates rise

b. Same: No effect on current equilibrium real GDP because in classical model the vertical LRAS curve always applies

c. Same: change in desired investment does not directly affect the demand for labor or supply of labor in classical model, so equilibrium and employment doesn’t change

d. Increase: decrease in equilibrium interest rate creates rightward and upward movement along supply curve of savings, so equilibrium savings increases

e. Increase: rise in current investment means (assumes) higher capital accumulation. All else equal it implies increase future production and higher equilibrium real GDP in future.

11-3 (back of book)

11-6 to prevent short run from increase in price level from temporary rise in oil prices shifts SRAS curve left, policy makers should decrease quantity of money in circulation which will cause AD to shift left and prevent equilibrium price level from rising in the short run

11-7 (back of book)

11-8 it isn’t possible for policy makers to stabilize both the price level and real GDP simultaneously in response to a temporary increase in oil prices. Stabilizing price level requires the quantity of money to decrease by stabilizing real GDP require increasing the quantity of money

11-10 stock goes down, home prices go down so household wealth goes down and consumption goes down; short run Keynes focuses on spending

 Recessionary gap = shift in AD and a short run reduction of equilibrium

 It’s the difference between short run equilibrium between AD and SRAS at less than full employment (on LRAS). When unemployment rises and input prices drop = aggregate demand shock