Week 11 Homework: Short-run Economic Fluctuations

ECO 120: Global Macroeconomics

Global Pandemic

1. Suppose the economy is at the long-run equilibrium when suddenly a global pandemic causes consumers to reduce their demand for many final products and services.

   a) Describe and illustrate the **short-run** effects on the price level, real GDP, and employment.

   b) Assuming government does not intervene to fix the problem, describe and illustrate the impact on the price level, real GDP, employment, and wages in the **long-run**.

   c) Given the state of the economy in the short-run (answer to problem (a)), suggest a change in government spending to reverse the problem without waiting for convergence to long-run equilibrium. Illustrate the short-run impact of this policy on price level, real GDP, and employment.

Change in Exchange Rates

2. Suppose interest rates increase in the Euro area leading to an appreciation of the Euro against the U.S. Dollar. Answer the following from the perspective of the United States.

   a) Describe and illustrate the **short-run** effects on the price level, real GDP, and employment.

   b) Assuming government does not intervene to fix the problem, describe and illustrate the impact on the price level, real GDP, employment, and wages in the **long-run**.

   c) Given the state of the economy in the short-run (answer to problem (a)), suggest a change in taxes to reverse the problem without waiting for convergence to long-run equilibrium. Illustrate the short-run impact of this policy on price level, real GDP, and employment.

Increase in Production Costs

3. Suppose global supply-chain production disruptions cause an increase in production costs.

   a) Describe and illustrate the **short-run** effects on the price level, real GDP, and employment.

   b) Assuming government does not intervene to fix the problem, describe and illustrate the impact on the price level, real GDP, employment, and wages in the **long-run**.

   c) Given the state of the economy in the short-run (answer to problem (a)), suppose the government passes a bill to give businesses grants to financially support businesses during the difficult time. Illustrate the impact of this policy on price level, real GDP, employment, and wages.

   d) Given the state of the economy in the short-run (answer to problem (a)), suppose the government passes a tax rebate bill that gives most consumers $800 to spend or save as they please. Illustrate the impact of this policy on price level, real GDP, and employment.