ECO 120: Global Macroeconomics
Week 12 Homework: Monetary Policy

1. Suppose an economy is originally at the long run equilibrium when there is a drop in businesses' economic outlook.

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

    (b) Suppose the goal of the Federal Reserve is to prevent or minimize a recession. Describe a monetary policy to achieve this goal.

    (c) Redraw your answer for part (a) and add to it the impact from the monetary policy that you suggested in part (b). Describe and illustrate the impact to equilibrium real GDP, price level, wages, and employment.

2. Suppose an economy is experiencing high inflation while real GDP is above potential GDP.

   (a) Illustrate the current state of the economy using the AS/AD model and the labor market supply and demand model. Don't shift anything yet, just show an initial state where real GDP is above potential GDP.

   (b) Suppose the goal of the Federal Reserve is to reduce inflation. Describe a monetary policy to achieve this goal.

   (c) Redraw your answer for part (a) and add to it the impact from the monetary policy that you suggested in part (b). Describe and illustrate the impact to equilibrium real GDP, price level, wages, and employment.

3. Suppose an economy is experiencing high inflation and recession at the same time (recession implies high unemployment and real GDP below potential GDP).

   (a) Illustrate the current state of the economy using the AS/AD model and the labor market supply and demand model. Don't shift anything yet, just show an initial state where real GDP is below potential GDP.

   (b) Suppose the goal of the Federal Reserve is to increase employment. What monetary policy can achieve this goal? Redraw your answer for part (a) and add to it the impact from the monetary policy that you suggest. Describe and illustrate the impact to equilibrium real GDP, price level, wages, and employment. Did inflation get better (lower) or worse (higher)?

   (c) Suppose the goal of the Federal Reserve is to decrease inflation. What monetary policy can achieve this goal? Redraw your answer for part (a) and add to it the impact from the monetary policy that you suggest. Describe and illustrate the impact to equilibrium real GDP, price level, wages, and employment. Did the recession get better or worse?