Consider an economy with a 10% inflation rate and 3% unemployment rate. Graph on AS/AD and Phillips Curve.

Now, explain correct open market operation and its effect on AS/AD, Phillips Curve, and the Money Market. Graph all 3.

After the open market operation, what happens to

Interest rates

Unemployment

Money supply

Real GDP

Price level

2

Graph a macroeconomy in LR EQ. Real GDP at full employment is 100B.

If the government decides to increase taxes by 10B and increase G by 10B, what will be the result? Graph and explain. What is this type of fiscal policy called?

Show the result of this change on the Phillips curve.

If no other action is taken, what will be the long run result of the government action? Graph result on AS/AD and Phillips.

Graph a macroeconomy in LR EQ. Now assume gas prices rise to $5 per gallon. Show the change in AS/AD and the Phillips Curve.

Assume this change in gas prices becomes permanent. Show the change in AS/AD, the Phillips Curve, and the PPC.

Assume an economy is in recession. Imagine the government decides to deficit spend to correct the problem. Graph the changes in AS/AD and the loanable funds market.

Given your answer above, what is the possible effect to Investment of the government's deficit spending? What is the situation called? How does it affect the change in AD that is expected?

5

Assume an economy is in a recession so deep that it is functioning on the Keynesian portion of the AS curve. Graph this situation. If G increases spending but AS remains horizontal, what is the result to REALGDP and the price level?

How does the above situation conflict with the short run Phillips Curve?

1. Assume that the United States economy is in recession.

   (a) Using a correctly labeled aggregate demand and aggregate supply graph, show each of the following for the economy.

      (i) Full-employment output

      (ii) Current output level

      (iii) Current price level

   (b) The federal government announces a major decrease in spending. Using your graph in part (a), show how the decrease in spending will affect each of the following.

      (i) Level of output

      (ii) Price level

   (c) Explain the mechanism by which the decrease in government spending will affect the unemployment rate.

(d) The Federal Reserve purchases bonds through its open-market operations.
   (i) Using a correctly labeled graph, show the effect of this purchase on the interest rate.
   (ii) Explain how the change in the interest rate will affect output and the price level.