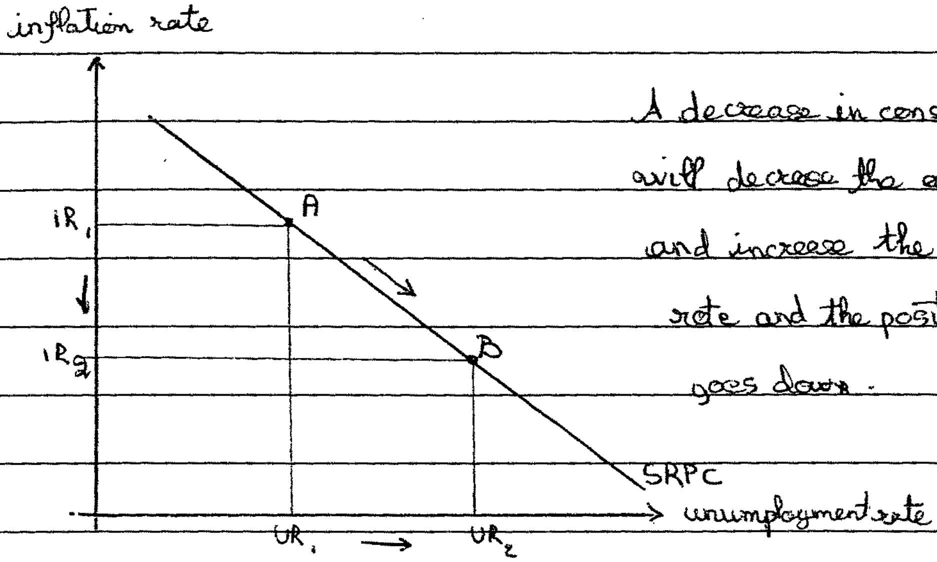
q1 macro 2008

Write in the box the number of the question you are answering on this page as it is designated in the exam.

Question 1

1A,



(a) A decrease in consumer spending will decrease the aggregate demand and increase the unemployment rate and the position on SRPC goes down.

Short Run Phillips curve

(b) Since the country certainly has automatic stabilizers, then, in a recession period, with lower wages, people will pay less taxes and the government will suffer a budget deficit.

(c) (i) $\$500 \text{ billion} = x \times \frac{1}{1 - MPC}$

$= x \times 5$

$x = \$100 \text{ billion}$

So with the action of the spending multiplier, the government will only have to do \$100 billion spending.

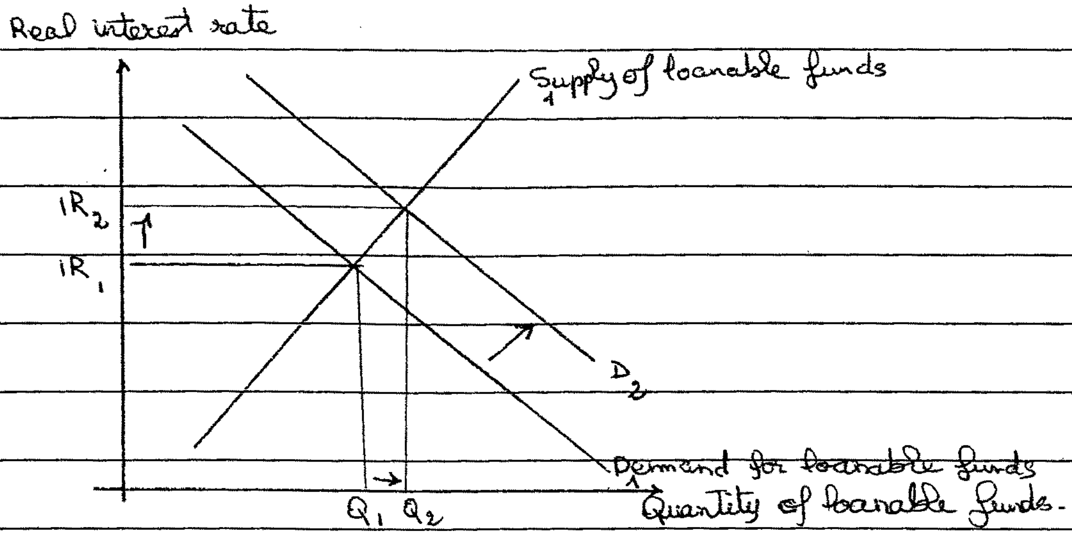
(ii) Since the tax multiplier is weaker than the spending multiplier, the reduction in personal income taxes will have to be larger than the government spending to achieve full employment.

Question 1

Write in the box the number of the question you are answering on this page as it is designated in the exam.

1A2

(d)



Market of loanable funds

An increase in the government spending will lead to a budget deficit and the government will have to loan funds to find an equilibriu in its budget. It is the crowding-out effet

So the real interest rate will ~~go~~ increase from IR_1 to IR_2.

(e) Since the interest rate went up, the investment will go down and the capital stock will not increase so the growth rate of the United States economy will slow down.