

Aggregate Demand and Aggregate Supply

- 1) Suppose there's an increase in aggregate demand. Under what circumstances would you expect the increase in aggregate demand to increase real GDP, while having little or no effect on the price level of the economy?
- 2) Suppose potential real GDP in the current quarter is \$5,000 billion and equilibrium real GDP in the current quarter is also \$5,000 billion. There's a sharp increase in the demand for exports during the year. Other things being equal, forecast the effect of that increase on inflation.
- 3) Assume that an economy exists in which all assets held by the public are automatically adjusted for inflation or deflation whenever the price level changes, there's no international trade, and real interest rates don't change when the price level changes. What would the aggregate demand curve for such an economy look like?
- 4) Imagine that the economy is currently operating at full employment. At the beginning of the year, all nuclear power plants are shut down because of protests about the risk of environmental contamination. As power companies shift to more expensive sources of electricity, the price of electricity triples. Predict the effect of the power plant closings on macroeconomic equilibrium.
- 5) Suppose that, after a period of labor unrest, the workers in a nation succeed in getting governing authorities to order a 25-percent increase in nominal hourly wages. Other things being equal, predict the impact of this settlement on macroeconomic equilibrium for the economy. Under what circumstances will the increase in the wage level reduce labor earnings?
- 6) Suppose the economy is in a deep recession. After extensive negotiations, labor unions and all other workers agree to a 25-percent cut in nominal wages, at the beginning of the following year. Describe a graph showing the impact of the wage cut on macroeconomic equilibrium.
- 7) Suppose the aggregate supply curve for an economy is a flat line. What would this imply about the relationship between real GDP and the price level? How will a decrease in aggregate demand affect the economy if the aggregate supply curve is a flat line?
- 8) Suppose the economy is currently in a deep recession. The Central Bank, which influences the supply of credit, takes actions to lower real interest rates. As real interest rates fall, business firms increase their demand for investment goods. How can the increase in demand pull the economy out of the recession, with little or no resulting inflation?
- 9) Suppose there's a severe drought in a nation whose agricultural output accounts for a large percentage of real GDP. What is the impact of the drought on the nation's aggregate supply curve and its macroeconomic equilibrium? Why is the drought likely to result in both inflation and a recession?
- 10) Typically, there are increases in both aggregate demand and aggregate supply for a growing economy. Use aggregate demand-aggregate supply analysis to explain how aggregate demand can increase in an economy, without causing inflation, if the quantity and productivity of resources are also growing.