

Homework 13

1. Using the formulas for, and the ideas behind, the IS and LM curves in the textbook, show graphically what the effect is of
 - (a) sales of government bonds by the New York Fed;
 - (b) a sudden increase in the economy-wide price level;
 - (c) an increase in government taxation of the young agents; and
 - (d) an increase in the expected inflation rateon the real interest rate and on output. Explain the effects in words: emphasize through what channel the effects occur.
2. Does the answer to any of the above questions depend on whether or not the economy is at full capacity?
3. Show how to derive the AD (aggregate demand) curve based on the IS and LM curves.
4. Show how to derive the AS (aggregate supply) curve.
5. If the marginal propensity to consume of the private sector is 10%, what would the ultimate effect on output of an initial \$1,000 increase in spending be (assuming that the initial increase came about because of a sudden burst of consumer confidence)? Explain the multiplier effect in this process; does it rely on assuming that the economy is below full capacity before the initial increase in consumer confidence (and if so, why)?