ID ........ Solution

# Make-up Quiz#1
# EE312 Macroeconomic Theory
# Section 046402

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**Instructions**

1. Use the tools we study in chapter 3 to analyze and answer the questions
2. Write out your ID at the upper right of the first page
3. There is 1 question with 2 subquestions.

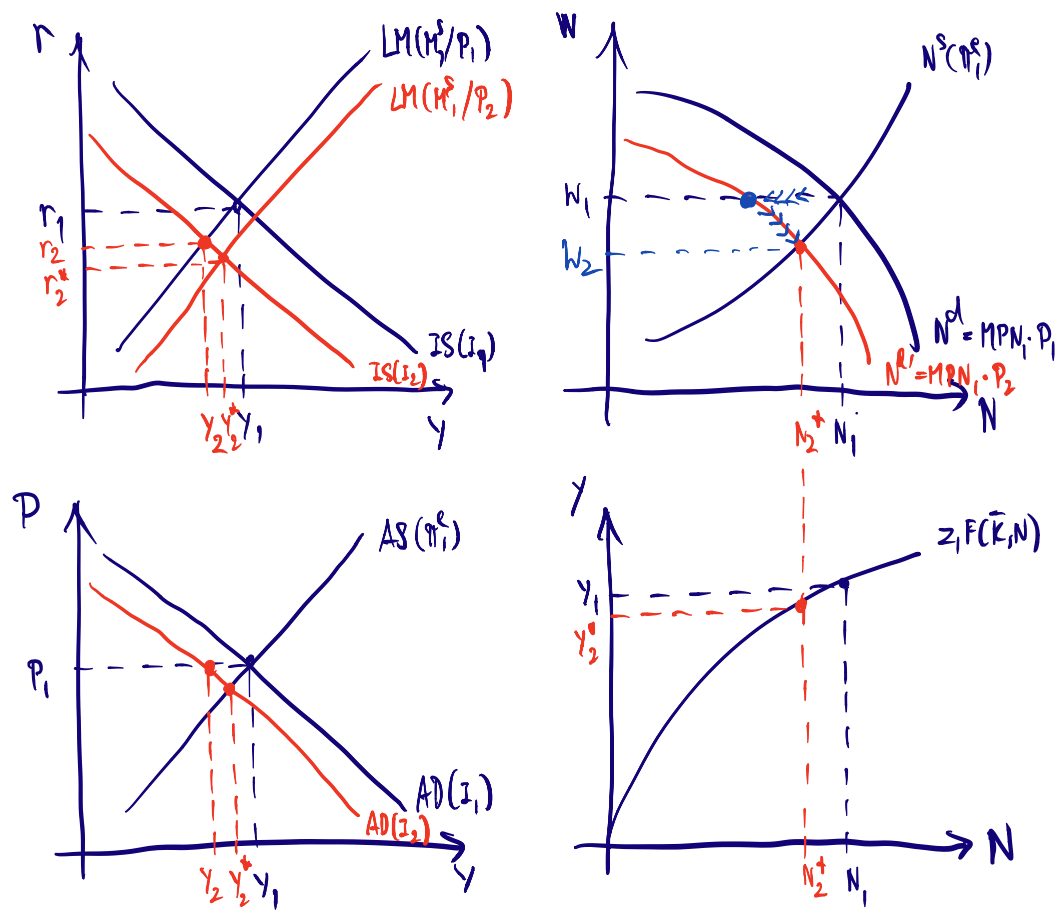
**Question 1 (100 points)** The Thai economy is initially at the equilibrium. The political instability results in a resignation of the Minister of Finance and creates a confidence crisis among investors. Answer the following questions:

(1.1) **(10 points)** Identify the shock. What happens toward aggregate demand and/or aggregate supply?

A negative AD shock due to a fall in autonomous investment.

(1.2) **(90 points)** Describe the process of adjustment after the shock identified in (1.1) hit the Thai economy in short run. Hint: Your answer should compose of 2 parts. The first one is diagrams of equilibrium in interest rate, output, nominal wage, employment, and price (45 points). The second part is the explanation (45 points).

$I \downarrow \ (I_1 \rightarrow I_2)$




1. $I \downarrow$ $(I_1 \to I_2)$ $\Rightarrow$ DAE$\downarrow$ $\Rightarrow$ $Y \downarrow$ $\Rightarrow$ IS - left.

2. $Y \downarrow$ $\Rightarrow$ $M^d \downarrow$ $\Rightarrow$ ESM, EDB $\Rightarrow$ $P_B \uparrow$ $\Rightarrow$ $r \downarrow$ $\Rightarrow$ $I \uparrow$ $\Rightarrow$ $Y \uparrow$ "crowding-out eff"

   partially offset

3. Given fixed P, $Y \downarrow$ due to $I \downarrow$: AD- left $\Rightarrow$ ESG $\Rightarrow$ $P \downarrow$.

4. Labor market : $P \downarrow$ $\Rightarrow$ $MPN \cdot P \downarrow$ $\Rightarrow$ $N^d$ – left : $N \downarrow$.

   $P \downarrow$ $\Rightarrow$ $\frac{W}{P} \uparrow$ $\Rightarrow$ $N \uparrow$ move toward eqm in labor market. $N_2^*$

   Goods market : $P \downarrow$ $\Rightarrow$ $M^S/P \uparrow$ $\Rightarrow$ LM - right $\Rightarrow$ $Y \uparrow$ "price effect!"

   $Y_1 \downarrow$ to $Y_2$ but $\uparrow$ back to $Y_2^*$