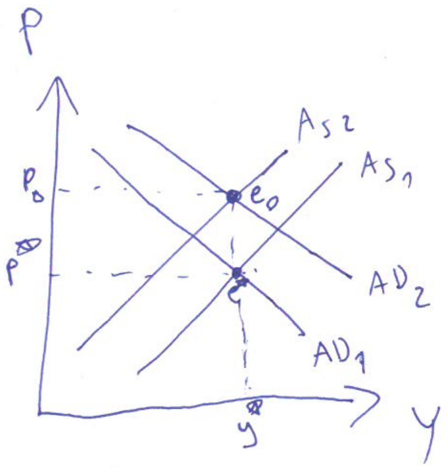
Student ID 6004647777

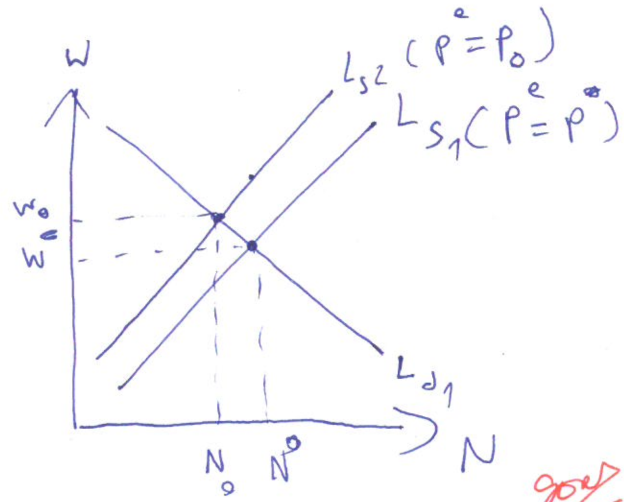
Quiz 5 Medium-term adjustment theorem (15 minutes)

15

Comment the following statement

Under the rational expectation, an anticipated monetary expansion will lead to an increase in price and output in the short-run.





good

If expansionary policy is anticipated worker will know in advance that price of the product will change from P^* to P_0 this will made L_s shift to the left $(P^e = P_0)$ because worker ~~~~ will negotiate for higher wage to math with an increase in price of the product from expansionary policy then will be higher cost for firm. firm will choose to hire less labor making firm can produce less output As will shift to the left (to AS$(P^e = P_0)$) when expansionary really implement AD will increase. AD will shift to the right (AD_2) the new equilibrium is at point e_e ∴ an anticipated monetary expansion policy will not increase an output but will increase the price in short run which is different from a shock policy So the given statement is partially false, because price increase but output does not

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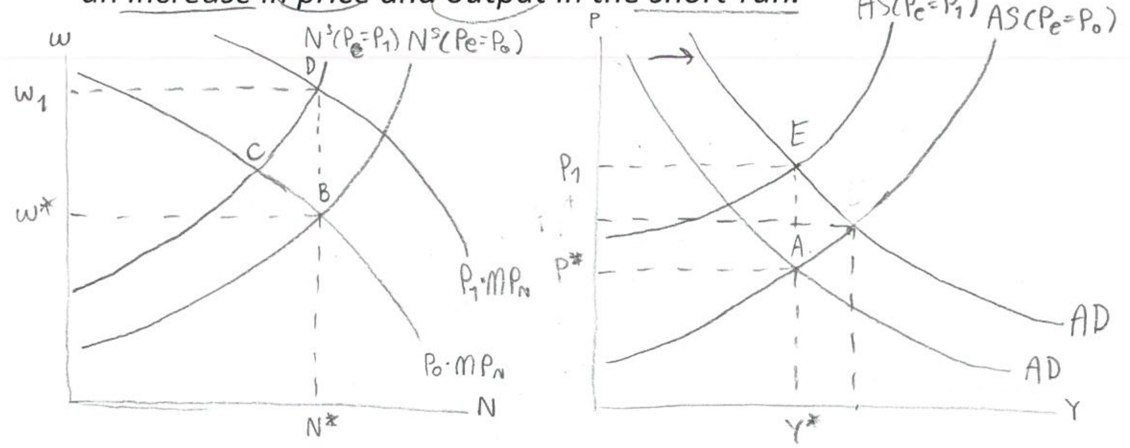
Quiz 5 Medium-term adjustment theorem (15 minutes)

15

Comment the following statement

Under the rational expectation, an anticipated monetary expansion will lead to an increase in price and output in the short-run.



The initial equilibrium in labor market and goods market is w^*, N^*, P^*, Y^* respectively. Now, suppose the expansionary monetary policy is anticipated, e.g. people expect the ~~interest rate~~ money supply to rise, no! their expected price will increase from P_0 to P_1, shifting the labor supply to the left. good This will result in less employment, and hence the output will decrease, shifting aggregate supply curve to the left.

If the monetary expansion is imposed, as ~~anticipated~~ implemented??, the aggregate demand will shift to the right, resulting in higher price in goods market, say P_1. Because the price is now higher, the value of marginal product of labor will increase, shifting the labor demand to the right. The final equilibrium in labor market is w_1 and N^*. This implies that the employment is equal to the naturate of unemployment but the wage rises to w_1.

In goods market, the final equilibrium is at point E where the equilibrium output is Y^* and the price P_1. Therefore, the anticipated monetary expansion will lead to an increase in price, but not output in the short-run under the rational expectation.

V. good