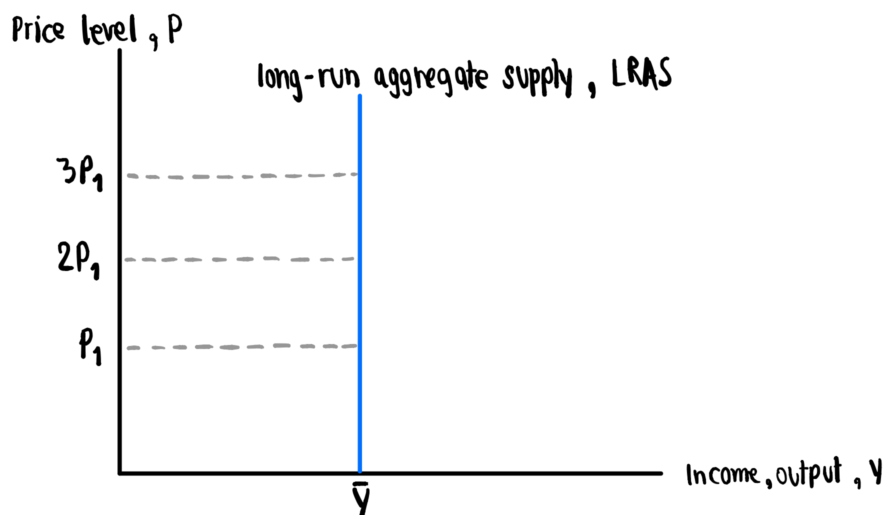
Question 1:

1.1) The classical model describe how the economy behaves in the long run, we derive the long-run aggregate supply curve from the classical model as a vertical line because, in the long-run, the potential output an economy can produce is not related to the price level. There are only two things that matter for potential output (mechanism):

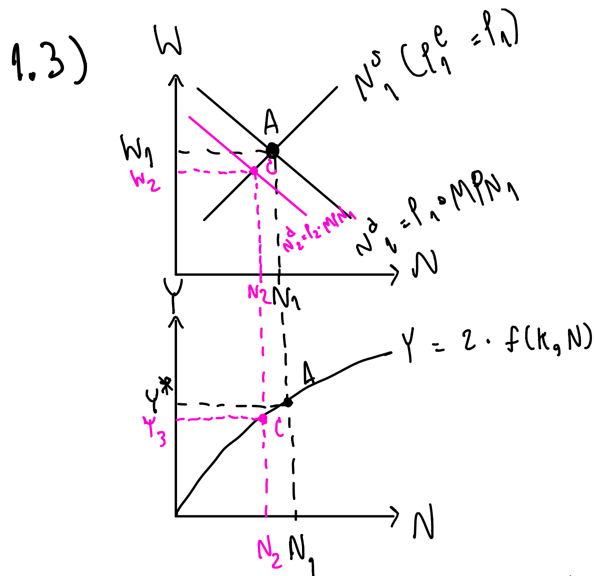
1) The quantity and the quality of a country's resources (fixed amounts of capital and labor)
2) How it can combine those resources to produce aggregate output (the available technology)

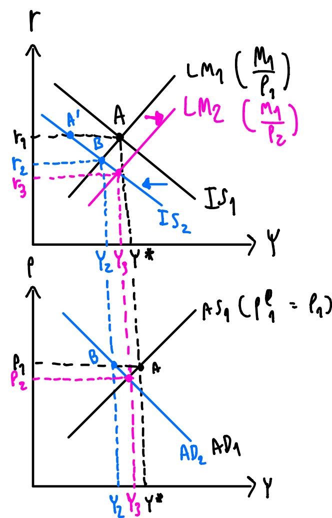
When an economy is producing exactly its full employment output($\bar{Y}$), the rate of unemployment is equal to the natural rate of unemployment. The LRAS curve is also vertical at full-employment level of output because this is the amount that would be produced once prices are fully able to adjust. In the short-run, some prices are sticky. This means that producers might respond to changes in the price level by changing their output. However, in the long-run, those prices get "UNSTUCK", and once they have fully adjusted the economy will produce the efficient, full employment output.



More info: Economist tended to assume that prices were fully flexible before the Great Depression. In times of high unemployment, they believed, wages will go down and restore full employment. There was just a slight problem: that didn't happen during the Great Depression! High unemployment and low output persisted for a long time. The logical conclusion is that wages (and other prices) are temporarily rigid.

1.3)





According to the graph, at point A, there is a loss in confidence in risky stocks and bonds. By doing this, it leads to a lower stock price, and a fall in consumption and investment, which makes the aggregate expenditure to fall. Also, output will fall from Y^* to Y'. At point r, there is a decline in the interest rate from r_1 to r_2. By doing this, consumption and investment will rise, and an increase in aggregate expenditure. Also output will rise (but less than Y^*).

At point P, AD will shift to the left from AD_1 to AD_2. In addition, it creates the excess supply of output. To clear the market, the price level has fallen from P_1 to P_2, and makes the real money to rise from $\frac{M_1}{P_1}$ to $\frac{M_1}{P_2}$. This make the LM curve to shift to the right. Moreover, the fall in interest rate will cause the consumption and investment to rise, and a rise of aggregate expenditure and output respectively. Additionally, a fall in price would make the VMP to fall, and a labor demand to fall and shift to the left. As a consequence, the wage, number of labour, and output will decline respectively. For the new equilibrium, output will fall from Y^* to Y^3, interest rate fall from r_1 to r_3, price will fall from P_1 to P_2, wage rate will fall from W_1 to W_2, labour will fall from N_1 to N_2. Eventually, the consumption and investment will be diminished

2) Emerging economies produce and fare deliberately unexpecteds products in comparison to developed counterparts while the two sorts of economies import and expend fundamental the same as kinds of merchadise. As emerging countries produce a larger number of products than they expend, rich countries deliver and devour wares in comparable sums. These systematic contrasts among emerging and developed economies influence their reactions to changes in the international price of commodities comparative with fabricates, enhancing business cycle unpredictability in emerging economies.

Consider, for example, an expansion in the relative price of commodities. In emerging countries, the share of commodities in all production is bigger than their share in total consumption. Accordingly, an expansion in the relative price of commodities expands the estimation of the sort of products delivered comparative with those expended, triggering an economic boom.

The higher value of commodities rises the amount of resources accessible to aggregate capital and increment utilization and furthermore builds the returns to capital accumulation and work procuring. In addition, there is an expansion in aggregate productivity as production inputs are reallocates across divisions. Interestingly, the share of commodities in production and utilization is significantly more comparable in developed economies. Along these lines, changes in the relative price of commodities smally affect the relative value of production and, accordingly, a minor effect on aggregate economic activity. The basic contrasts in the patterns of production and exchange among emerging and rich countries are significant in representing the higher business cycle volatility of emerging economies. Ranging from differences in institutional quality, money related improvement or the viability of public policy, to contrasts in the size and steadiness of the shocks looked by these economies are the merchanism complements.

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