ID ...... Solution ......

Quiz#1
EE312 Macroeconomic Theory
Section 046402

Instructor: Panit Wattanakoon
Semester 1, 2020

September 11, 2020

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 4 subquestions. Answer only in the given space.

Question 1 (100 points) The Thai economy is initially at the equilibrium. COVID-19 forces the Thai government to impose a lock down policy. Curfew restricts people mobility and shopping malls are shut down. People are not allowed to spend freely than they would otherwise do. Work-at-home policy is mostly applied for all labors.
(1.1) **(10 points)** Identify the shock. What happens toward aggregate demand and/or aggregate supply?

1. A negative AD shock from a fall in autonomous consumption.

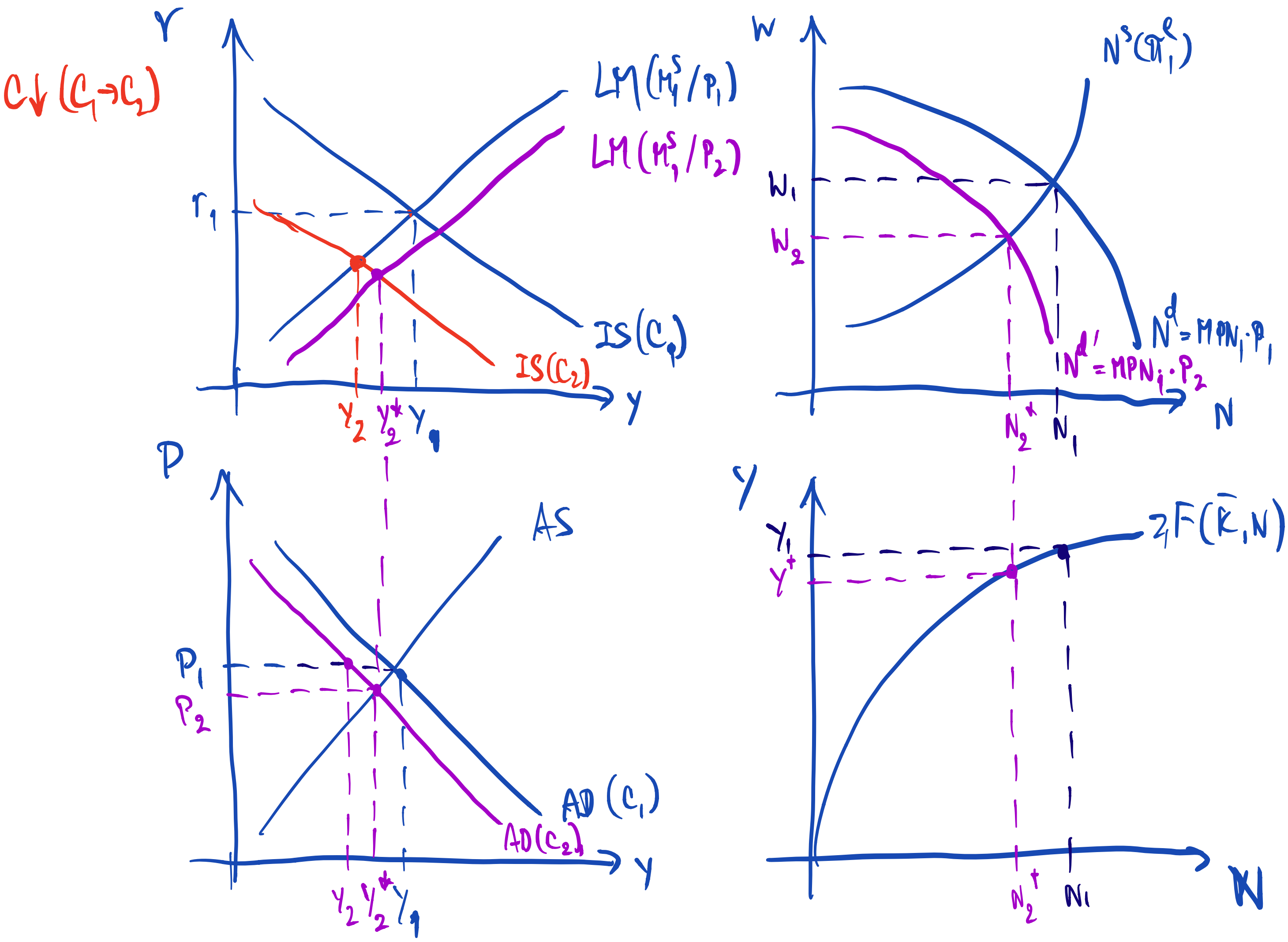
2. A negative AS shock from work-at-home policy as marginal product of labor falls. Or any other reasonable explanation

(1.2) **(40 points)** Explain the process of adjustment in short run. Fill in all the blank space below. Hint: Pick only one shock

1. If real interest rate remains the same ($\bar{r}$), DAE shifts ... right ...
   $\Rightarrow$ output (Y) ... $\downarrow$ ... for all level of ... r ...
   $\Rightarrow$ IS shifts to the ... left ...; the size of shift is ... $\frac{1}{1-b-i_2}$ ... ΔC
2. As Y ... $\downarrow$ ..., Real money demand ... $\downarrow$ ... , Excess ... supply for money ..., ... Excess demand ... bonds, Bond price ... $\uparrow$ ... and equiliribium interest rate ... $\downarrow$ ...
   As r ... $\downarrow$ ..., investment ... $\uparrow$ ..., output ... $\uparrow$ ... (move along IS curve) the second effect is called the ... crowding-out ... effect.
3. From (1) and (2), IS curve shifts to the ... left ..., and then Y ... $\downarrow$ ... for all levels of price. Hence, AD shifts to the ... left ... Y ... $\downarrow$ ... and P ... $\downarrow$ ...

- Labor market
  As P ....↓.. , real wage ...↑...... and Y ....↑...... (movement along AS curve)
- IS-LM
  As P ...↓..., real money supply ...↑..... to ...$\frac{M_1^s}{P_1}$.....
  LM shifts to the ...right.........
  Output ....↑........
  This is called the ..price.. effect.

(1.3) **(40 points)** Draw diagrams. Show how the shock identified in (1.1) affects equilibrium interest rate, output, price, nominal wage, and employment. Hint: 4 diagrams.



(1.4) **(10 points)** Explain self-correcting mechanism toward the long-run equilibrium. Fill in all the blank space below.
After time passes by, workers realize that they should change their ..price.... expectation

1. If nominal wage remains the same ($\bar{W}$), labor will choose ..less.. leisure than work.
   ⇒ employment (N) ....↑...... for all level of ..W..
   ⇒ N^s shifts to the ..right..
2. As N ....↑......, given price fixed, Y ....↑..........., AS shifts ..right.. towards ..full employment.. equilibrium