



Problem sets 1: Data and measuring business cycles

EE312: Intermediate macroeconomics

Semester 1/2018

Instructor: Dr. Kittichai Saelee

Due on September 5th, 2018 at the BE office. (before 3 pm)

Instruction

1. There are three parts. Part I is true/false questions. Part II has one essay-based question. Attempt all!
2. Please put the answer of part I and part II in two separate paper. Your TA will grade part 1; meanwhile I will grade part 2.
3. In part I, make it precise. The most effective way to answer True/false question is to strike to the point, and find a rebuttal case if you believe that it is incorrect. (As you may guess, the most likely answer should be either false or uncertain.)
4. In part II, when you compose an essay, it means that you have to answer by writing in complete sentences and in paragraphs. Please do not answer as if you were preparing a note-taking for your own study.

Part I:

1.1) Monetary policy is more effective under elastic money demand than under inelastic money demand.

1.2) Aggregate supply curve is flatter under variable wage model than under fixed wage model.

First, the flatter AS curve implies that output increases a lot when price rises. Given the variable wage, rising price leads to an increase in labor demand, and hence employment and output. However, the increase in employment would be smaller when compared to the increase that arises under the fixed wage; rising wage partially offsets the effect of increases in labor demand. As a result, it is a fault to assume that AS is flatter under variable wage.

1.3) Consumer price index is a fair and unbiased measurement for the cost of living of households.

No, the CPI overestimates the true cost of living because it fails to consider the possibility of substitution effect. The required expenditure would have been too high under the fixed weight calculation. As for the substitution effect, consumers can mitigate the impact by switching toward a product whose price is relatively cheaper. This implies that the required expenditure could be slightly lowered, while the consumer can still remain the same happiness as before.

1.4) Keynesian government multiplier is *always* smaller than AS/AD-based government multiplier.

This should go with the opposite. Keynesian multiplier should "generally" be bigger than AD/AS-based multiplier. One should note that, under the IS-LM model, the effect of multiplier gets offset by the crowding-out effect. Under the AD-AS model, price adjustment leads to further offsetting results. This follows from a decrease in the real liquidity, causing a further increase in the

interest rate, and hence producing even more pronounced effect of the crowding-out.

Note that we can neither conclude that Keynesian multiplier is always bigger than AD/AS model. A counter example is when (i) LM curve is a horizontal curve and (ii) AS curve is a horizontal curve (price fixed).

Part 2: Essay question.

Within the variable price-fixed wage version of the Keynesian model analyze the effects of a loss of confidence in risky stocks and bonds such as occurred in the 2007-09 financial crisis.