Exercise 1

1. What are the four macroeconomic agents? What are the three markets in which the agents interact?
   Ans: The 4 macroeconomic agents are Households, Firms, The government and The rest of the world. The 3 markets are The goods-and-services market, The labor market and The money market

2. What is sticky price? Explain why price may be sticky?
   Ans: Sticky price is when the price adjusts slowly to the equilibrium, so the market takes time to clear. Price may be sticky because when the prices adjust to restore equilibrium the price reacts slowly to change in demand and supply.

3. Explain the four main categories of unemployment.
   Ans: - Frictional unemployment is the unemployment when people are looking/switching for jobs.
   e.g. people change jobs to find better workplaces.
   - structural unemployment is the unemployment as a result of changes in the structure of the economy that result in a significant loss of jobs in certain industries.
     e.g. newspaper workers are replaced by E-Book workers.
   - cyclical unemployment is the unemployment that is above frictional plus structural unemployment, due to fluctuations in business cycles.
     e.g. when the economy is good.
   - seasonal unemployment is the unemployment due to changing seasons.
     e.g. rice farmers are laid off in summer.

4. classify the following events into the categories of unemployment.
    - Some friends just graduated from college and have been looking for jobs
      Ans: Frictional unemployment.
    - Christine lost her job as a biologist at a biotech-company when the whole industry went into recession.
      Ans: Cyclical unemployment.
    - dirk used to work as a wooden-doll maker. Now all kids want plastic dolls, so he is out of work.
      Ans: Structural unemployment.
    - The hotel part-timers were laid off during low season.
      Ans: Seasonal unemployment.
    - Aditi, a high-tech engineer, just decided to quit her job; she is being interviewed for a better-paid job in a multinational company.
      Ans: Frictional unemployment.
    - A man lost his job as a public reader as literacy has increased in his village.
      Ans: Structural unemployment.

5. Suppose there are 100 people in labor force and 60 people currently in employment. Find the unemployment rate. Can we find labor force participation rate? If not, what information do we need?
   Ans: Unemployment rate is 0.4. No, we cannot find the labor force participation rate because we need to know the amount of population.

6. What is the discouraged-worker effect? How can it affect the unemployment rate?
   Ans: Discouraged-worker effect is people who want to work but cannot find jobs become discouraged and stop looking for work. This means that they exit the labor force. As a result, the unemployment rate falls.

7. On average, nations in Europe pay higher unemployment benefits for longer periods of time than the US. How would this affect the unemployment rates in these nations? Explain which type of unemployment is most directly affected.
   Ans: The unemployment rates in Europe will increase and the unemployment rates in the US will decrease. Structural unemployment is most directly affected because it is about geographical change.

8. What is inflation? It is often said that inflation reduces one's purchasing power, and hence inflation is bad. How can inflation reduce one's purchasing power? Is there a case where inflation may not be bad?
   Ans: Inflation is an increase in the overall price level. Inflation by itself does not reduce one's purchasing power unless our wages are fixed. For example, if you have got 100 baht today you can buy 10 apples. Tomorrow you still have the same amount as yesterday but you can buy only 8 apples because the price of apples has increased. There is a case that inflation may not be bad. Such as if the bank increases the interest rate, the saver will get more money.

9. Who - lender or borrower - is better off, given unanticipated deflation? Explain with examples.
   Ans: Borrower is better off because the lender will not charge interest. For example, you borrow your friend's money for 20 baht today and when you return it tomorrow you still return 20 baht but the value of 20 baht has decreased.

10. When inflation is anticipated, what will the central bank do with the interest rate? (Hint: Fisher Equation)
    Ans: The bank will increase the interest rate.

11. The CPI is 120 in year 1 and 150 in year 2. All inflation is anticipated. If the bank charges an interest rate of 30%, what is the bank's real interest rate?
    Ans: The bank's real interest rate is -0.2

12. Explain why inflation is necessary to a growing economy with reference to the money supply.
    Ans: Because inflation may change the distribution of income and this helps to drive the economics.

13. What are the two administrative costs of inflation? Explain.
    Ans: There are menu cost and shoe leather cost. The menu cost is the costs from changing menus/price lists frequently. The shoe leather cost is the opportunity cost of holding cash outside banks is high.

14. Draw a diagram of business cycles and the trend line. Label the four phases of business cycles. Answer the following questions.
   - Which phase do you expect to see inflation?
     Ans: Peak
   - Which phase do you expect to see high unemployment?
     Ans: Trough
   - Which phase should the government use expansionary policy? Give example.
     Ans: Recession. When the output begins to fall down means that people will become unemployed, so the government has to use expansionary policy to boost the economy.
   - Which phase should the government use contractionary policy? Give example.
     Ans: Expansion. When the output grows up to the peak phase means that there are too many people employed, so the government should use contractionary policy to slow down the economy.
   - What factors determine the trend line?
     Ans: Determined by the quantity and quality of labor and capital.

15. An article states that capital stock and labor force are both increasing at an annual rate of 7%. The same article also states that real output is growing by 11%. Explain why this is possible.
    Ans: This may mean that people are entering the labor force and the output growing up.