Assignment 7; Chapter 13 Questions 2, 4, 5, 9

2. Suppose the current administration decides to decrease government expenditures as a means of cutting the existing government budget deficit. a) According to the aggregate demand and supply analysis, what will be the effect of such a measure in the short run? Describe changes in the inflation rate and output level. b) What will be the effect on the real interest rate, inflation rate, and output level if the Federal Reserve decides to stabilize the inflation rate?

4. The following table shows the inflation rate and output level for four consecutive periods in a given economy. In period 1, the economy is at its long- run equilibrium (i. e., the inflation rate equals its target and output equals potential output). In period 2, there is a temporary supply shock (e. g., an increase in energy prices).

Period	Inflation rate (%)	Output ($ trillions)
1	2.5	8
2	4.5	7
3	2.5	6
4	2.5	8

a) Based on the table, determine which type of response was implemented by policy makers (e. g., no response versus stabilizing inflation or economic activity).

b) Show your argument using a graph (draw the MP curve and the AD/ AS diagram consistent with the table data).

5. Suppose one could measure the welfare gains derived from eliminating output (and unemployment) fluctuations in the economy. Assuming these gains are relatively small for the average individual, how do you think this conclusion would affect the activist/ nonactivist debate?

9. The Taylor rule suggests that the policy rate target should be increased when the output gap is positive. Do you think the Taylor rule encourages or discourages demand-pull inflation? Which might be a limitation of the Taylor rule with respect to demand- pull inflation?

11. Suppose that f is determined by two factors: financial panic and asset purchases. a) Using an MP curve and an AS- AD graph, show how a sufficiently large financial panic can pull the economy below the zero lower bound and into a destabilizing deflationary spiral. b) Using an MP curve and an AS- AD graph, show how a sufficient amount of asset purchases can reverse the effects of the financial panic depicted in part (a).

Not From the book:

In season three of the “House of Cards” president Fran Underwood is pushing to pass a bill called “AmericaWorks”. The goal of AmericaWorks is to create jobs for all Americans. The congress is against it and so he tries to fund the program by getting money from funds allocated to other programs (emergency funds for extreme weather). How do you think the program affect the level of economic activity and inflation in the long run and short run? (You can make up your own assumptions or make proposal if needed.)