

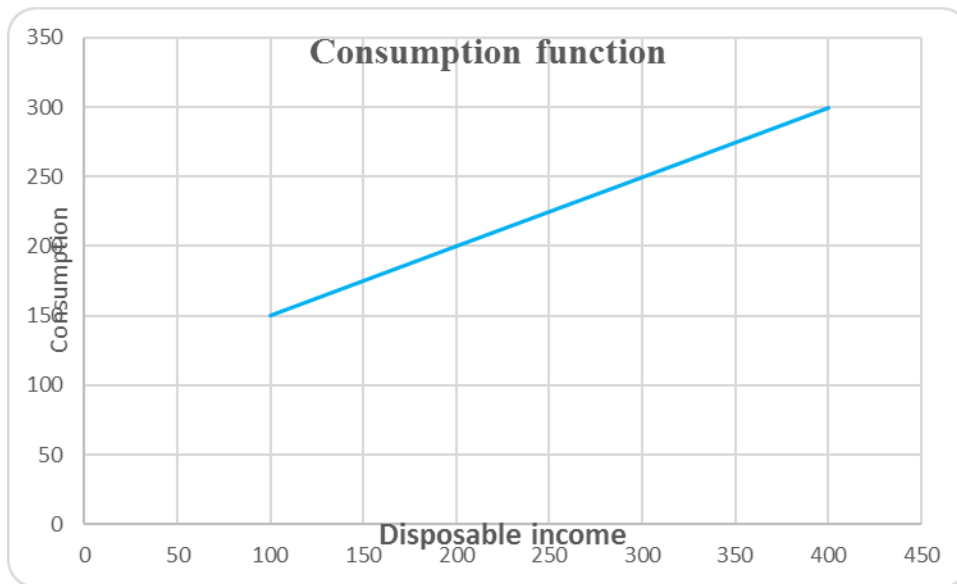
Economics

Name

Institution

CHAPTER 9**Question 1**

a)



b) Consumption function slope = change in consumption/ change in disposable income

$$= \frac{150}{300} = 0.5$$

Real Disposable Income (billions)	Expenditure (billions)	Savings (billions)
100	150	-50
200	200	0
300	250	50
400	300	100

Saving function slope= change in savings /change in disposable income

$$=150/300$$

$$=0.5$$

Question 4

- a) An increase in the net taxes will negatively affect consumption by lowering the disposable income.
- b) An increase in the interest rate will shift the consumption function downward since consumers will consume less and save more to earn high interests.
- c) An increase in the consumer confidence will positively affect the consumption function since consumers will purchase more when they are optimistic.
- d) An increase in the price level will reduce consumption thus negatively affecting the consumption function.
- e) An increase in the consumers' net wealth will increase the consumption thereby positively affecting the consumption function.
- f) An increase in the disposable income will increase consumption thus positively affecting the consumption function.

Question 9

Simple spending multiplier=1/MPS. However, MPS+MPC=1

$$\text{Spending multiplier} = \frac{1}{(1-MPC)}$$

Where

MPS=Marginal propensity to save

MPC= Marginal propensity to consume

- a) MPC=0.9

$$\text{Spending multiplier} = \frac{1}{(1-0.9)} = 10$$

$$\text{Change in real GDP} = 10 * 10$$

$$= 100 \text{ Billion}$$

Real GDP will decrease by 100 billion

b) MPC= 0.75

$$\text{Spending multiplier} = \frac{1}{(1-0.75)} = 4$$

$$\text{Change in real GDP} = 4 * 10$$

$$= 40 \text{ Billion}$$

Real GDP will decrease by 40 billion

c) MPC=0.6

$$\text{Spending multiplier} = \frac{1}{(1-0.6)} = 2.5$$

$$\text{Change in real GDP} = 2.5 * 10$$

$$= 25 \text{ Billion}$$

Real GDP will decrease by 25 billion

CHAPTER 10

Question 3

- If the actual price level exceeds the expected price level reflected in long-term contracts, real GDP equals 14.2 and the actual price level equals 130 in the short run.
- The situation described in part (a) result in an inflationary gap equal to 0.2
- If the actual price level is, lower than the expected price level reflected in long-term contracts, real GDP equals 13.7 and the actual price level equals 110 in the short run.
- The situation described in part (c) result in a recessionary gap equal to 0.3

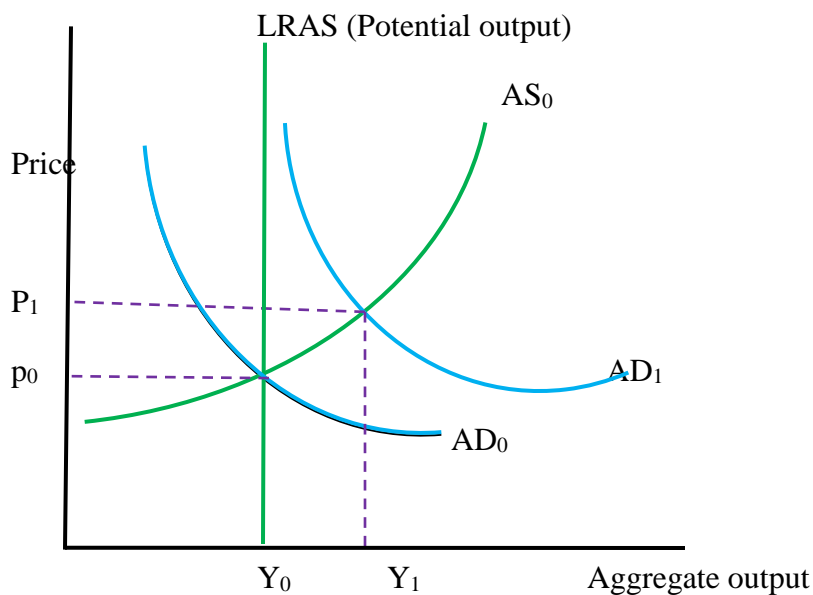
e) If the actual price level equals the expected price level reflected in long-term contracts, real GDP equals 14 and the actual price level equals 120 in the short run.

f) The situation described in part (e) result in an equilibrium gap equal to 0

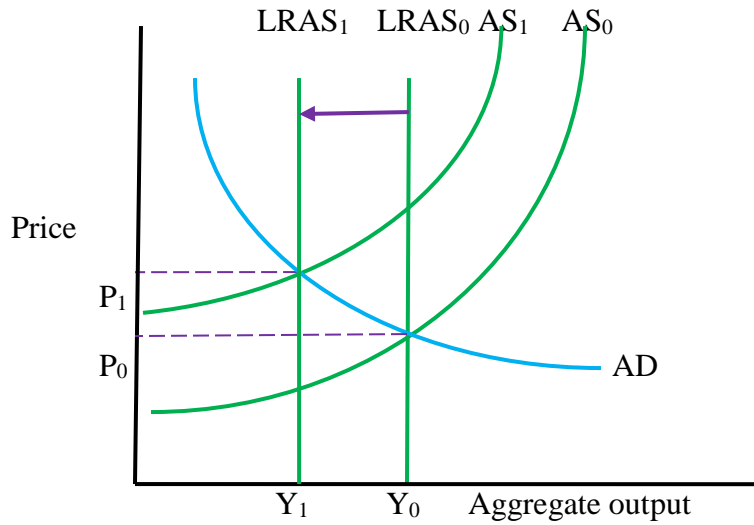
Question 5

Three factors that can change the economy's potential output include

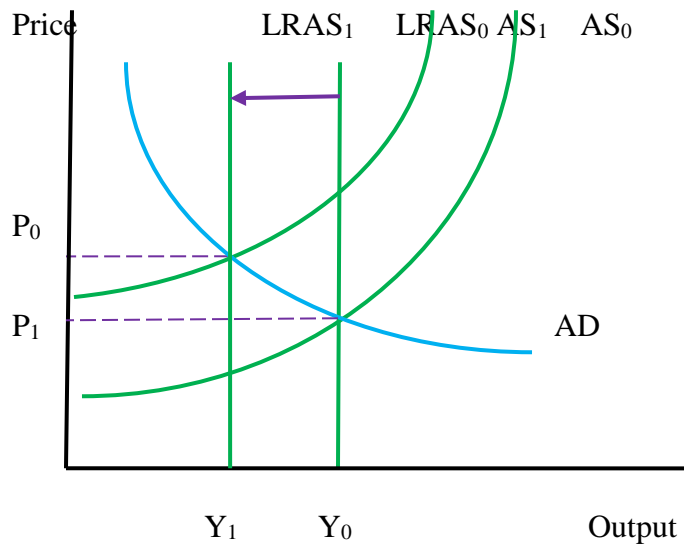
- Supply of resources in the economy
- Technological level
- Production incentives provided by the economic system.



In the long run, the equilibrium output and price will be Y_0 and P_0 . A shift of the aggregate demand curve from AD_0 to AD_1 will increase the aggregate output to Y_1 and price to P_1 in the short run. However, in the long run, the price increases to P_1 but the aggregate output is constant. In the long run, output is fixed to the potential output but the price is flexible to obtain the equilibrium at the potential aggregate output.

Question 6

A supply shock is an unexpected event or occurrence that changes the supply of a commodity thereby resulting to a sudden change in the price of the commodity. The shock can be negative or positive (McEachern, 2015). An adverse supply shock can be caused by a war for an example. If a war breaks out in the manufacturing zone, supply will be cut short. The supply function will shift from AS_0 to AS_1 . This will shift the quantity supplied from Y_0 to Y_1 . This will in turn increase the price from P_0 to P_1 . The change in output and the subsequent change in price will finally form a new point of equilibrium at Y_1P_1 , thus shifting the long run potential output from $LRAS_0$ to $LRAS_1$.



A beneficiary supply shock can occur if there is a sudden decrease in the cost of resources. In such a case, the quantity produced and supplied will increase from Y_0 to Y_1 . An increase in the quantity supplied will lower the price from P_0 to P_1 . The interaction of increasing supply and decreasing prices will in the long run form a new equilibrium at Y_1 P_1 , thus shifting the potential output from $LRAS_0$ to $LRAS_1$. A supply shock whether negative or positive shifts the aggregate output in the long run as opposed to a demand shock (McEachern, 2015).

Reference

McEachern, W.A. (2015). *ECONeconomics* (4th Ed.). Stamford CT: Cengage Learning