

Tutorial 9: Aggregate Demand, Aggregate Supply, and Inflation

- 1) Graphically illustrate the impact of the increase in the price level upon equilibrium output.
- 2) Explain the consumption link. Summarize the consumption link with regard to a decrease in the price level.
- 3) Summarize the impact of fiscal and monetary policies on the aggregate demand function.
- 4) Using aggregate supply and aggregate demand curves, indicate what impact each of the following would have on the price level and on the equilibrium level of aggregate output in the short run.
 - (a) The Central Bank buys bonds in the open market.
 - (b) The economy is far below capacity and the government increases government spending.
 - (c) The floods in the Midwest in 1993 destroyed a large portion of the United States' agricultural crops.
- 5) Show using graphs and explain what is the likely impact of expansionary policies when the economy is operating at excess capacity on the flat, horizontal portion of the AS curve? Graphically illustrate this policy effect.
- 6) Assume that in the long run input prices fully adjust to changes in output prices. Use a diagram to indicate the effect of an expansionary fiscal policy on the price level and equilibrium level of output in the long run.
- 7) Define cost-push inflation. Using an AS/AD diagram, illustrate how cost-push inflation affects the level of aggregate output and the price level in the economy. Suppose that the government uses expansionary fiscal policy to counter the effects of the cost-push inflation. Indicate on the diagram the impact of this policy on the price level and level of aggregate output.
- 8) In 1993 there was a severe drought in Maldives. As a result of the drought, approximately two-thirds of the country's agricultural crops were destroyed. Using an AS/AD diagram, indicate what effect this drought would have on the overall price level and the equilibrium level of output. The Maldivian government is considering a number of policies to counter the effects of the drought on the economy. For each of the following policies, draw a graph that indicates the effects of the drought and then indicate how the policy would affect the overall price level and level of equilibrium aggregate output in Maldives.
 - (a) The government is considering reducing net taxes.
 - (b) The monetary authority in Maldives is considering a one-time increase in the money supply.
 - (c) The government is considering reducing public investment in agriculture and not spending that money on any other projects.
- 9) Will a decrease in inflationary expectations affect aggregate supply or aggregate demand? Explain why it affects the one you chose. Using an AS/AD diagram, illustrate how a decrease in inflationary expectations affects the output level and the price level in the economy. Explain why these changes occur.