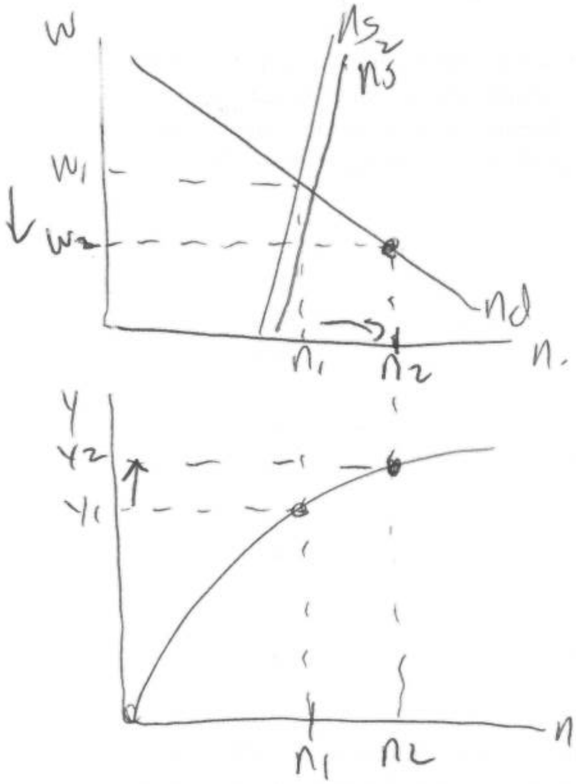
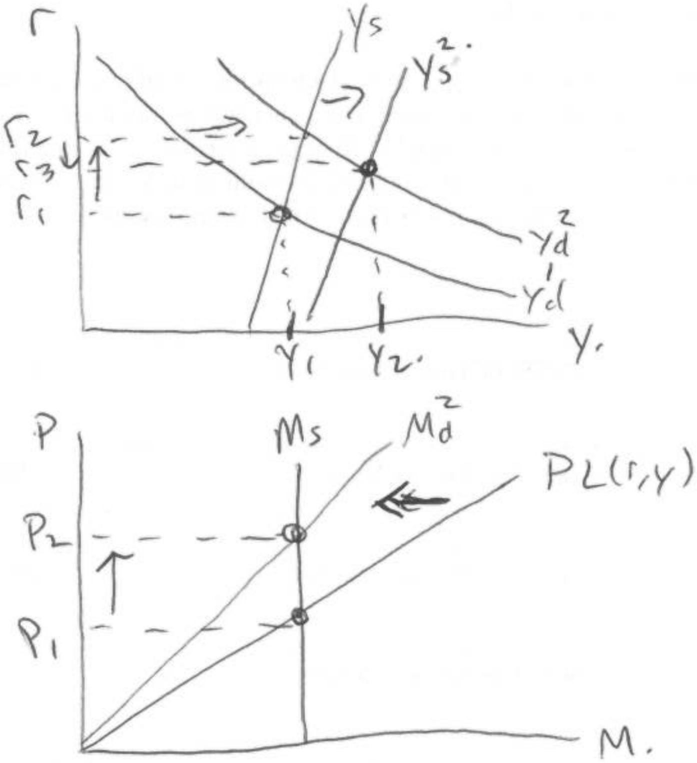
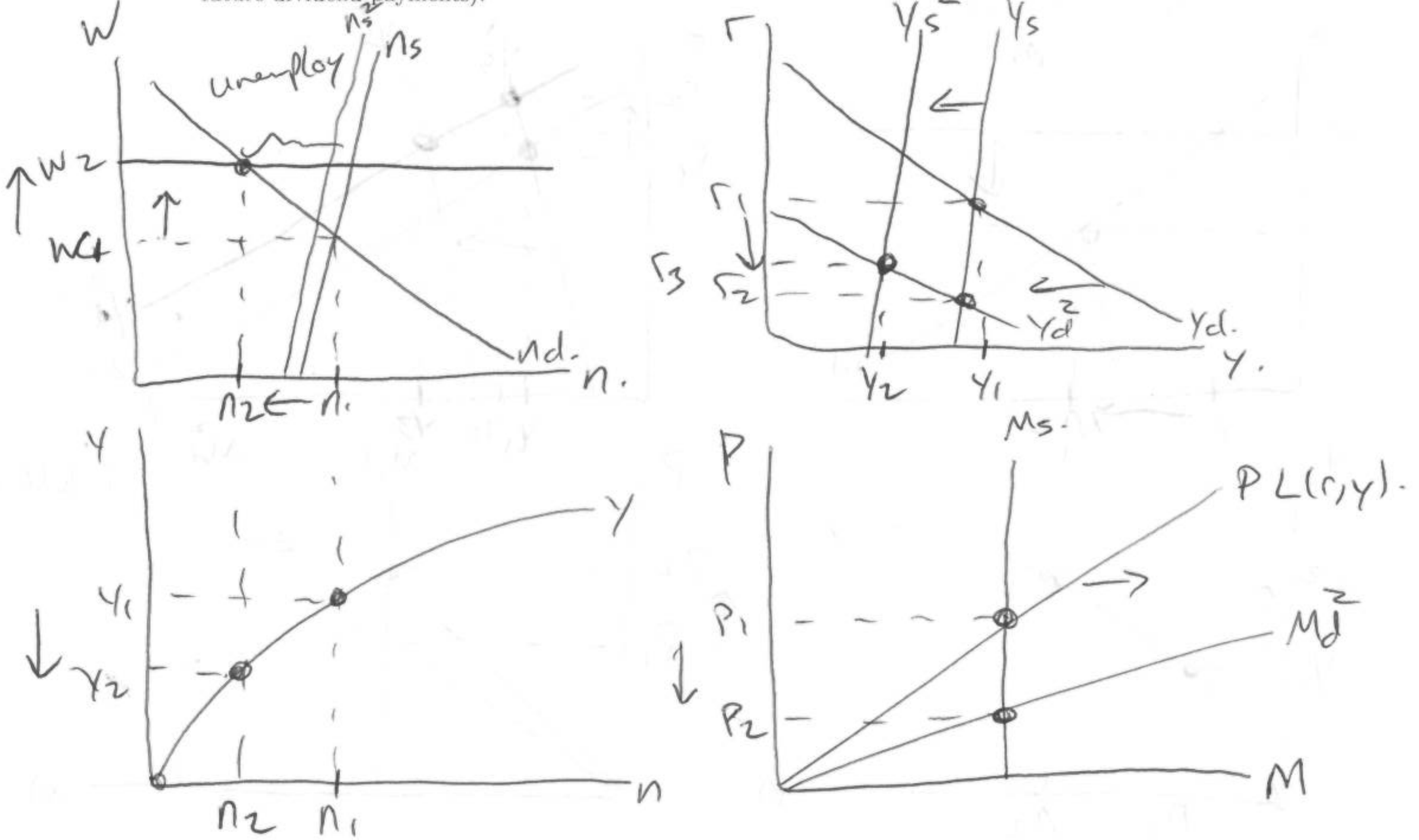
1. Suppose the economy is at its full employment equilibrium. Describe and illustrate the effect of an decrease in the depreciation rate.





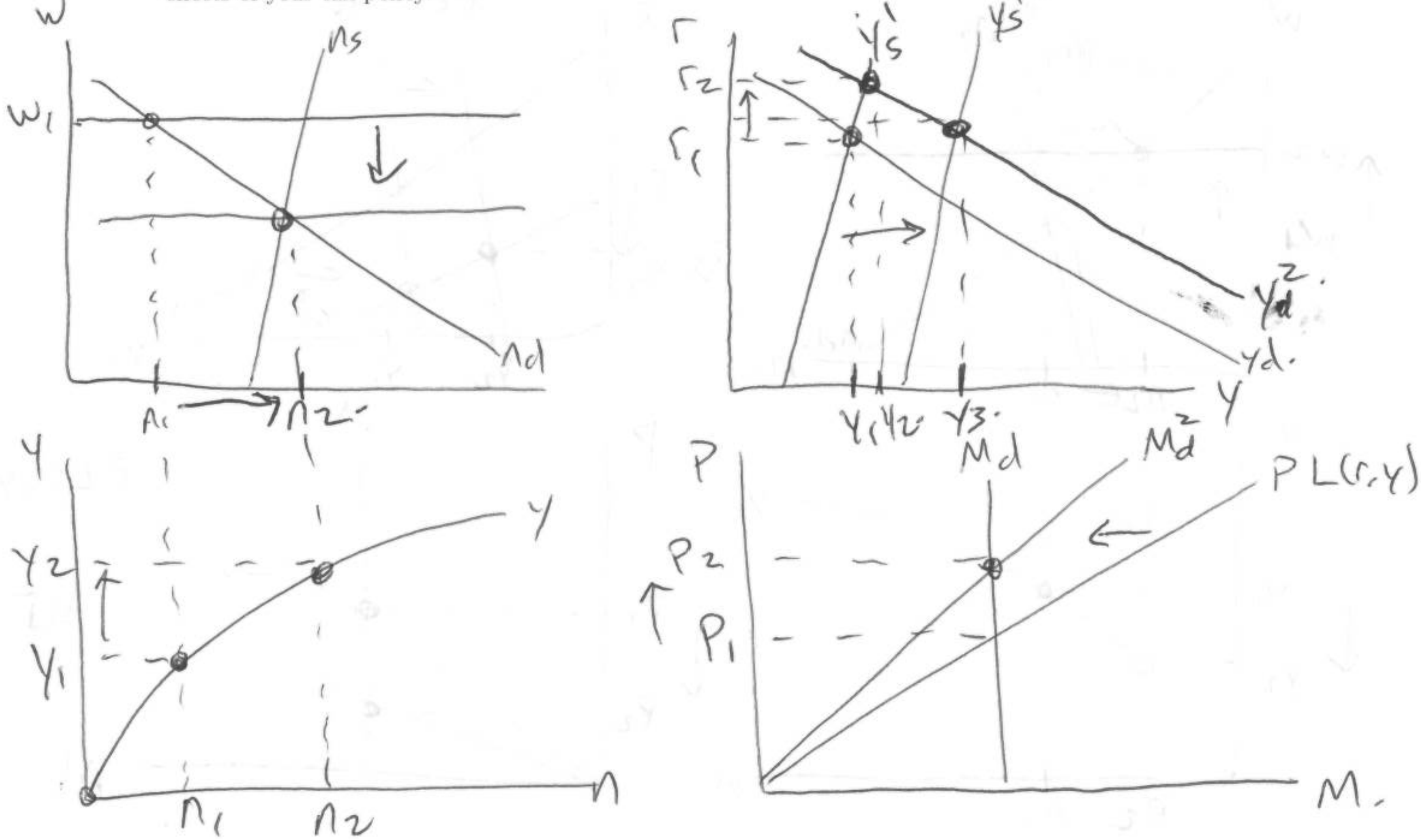
real wage ↓
employment ↑
real GDP ↑
interest rate ↑
Price level ↑
consumption ↓
investment ↑

2. Suppose the economy is at its full employment equilibrium. Describe and illustrate the effect when consumers expect the stock market to lose value in the future (consequently, they expect a decrease in future dividend payments).



Prize level ↓
real wage ↑
employment ↓
unemployment ↑
real GDP ↓
interest rate ↓
consumption ↓
investment ↓

3. Suppose the economy is at a production level below its fully-flexible price outcome (potential GDP). Describe and illustrate the unemployment situation. Suggest a tax policy to reduce unemployment, increase consumer spending, and increase real GDP. Describe and illustrate the general equilibrium effects of your tax policy.



↓ Taxes, ↑ Gov't Spending. ⇒ Yd shift right.

⇒ ↑ interest rate

⇒ Md pivots left.

⇒ ↑ Price level.

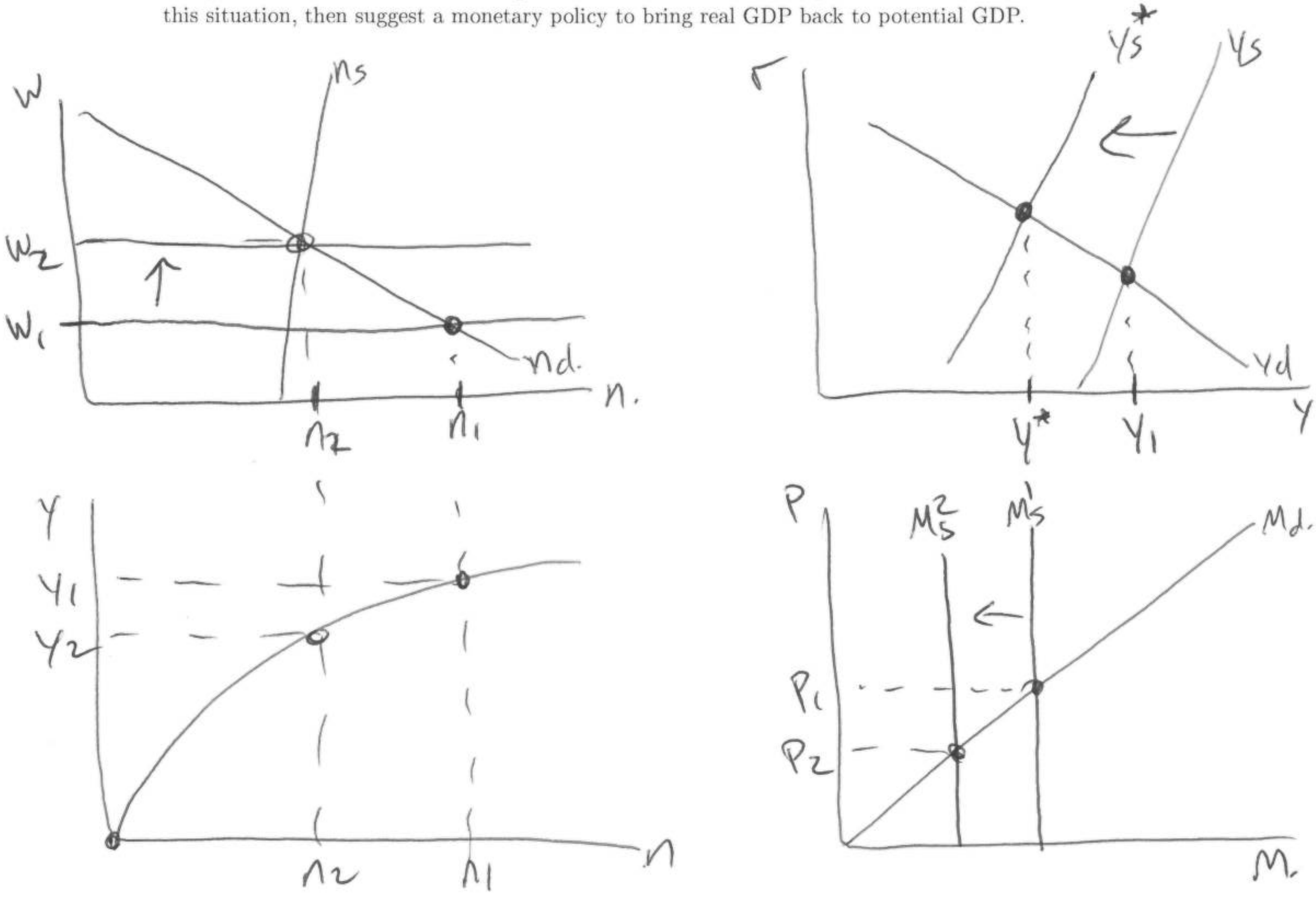
⇒ ↓ real wage.

⇒ ↑ employment / ↓ unemployment.

⇒ Ys shifts right.

⇒ real GDP increases.

4. Suppose the aggregate production level for the economy is starting to move above its fully-flexible price outcome. This situation is the beginning a bubble, because the economy will be above its sustainable level, and will come down in the long-run as labor markets reach equilibrium. Describe and illustrate this situation, then suggest a monetary policy to bring real GDP back to potential GDP.



Decrease Money Supply.
=> ↓ Prize level.
=> ↑ real wage.

Ys shifts left.

Labor market.
↑ real wages.
employment decreases
real GDP decreases