ECONOMIC FLUCTUATIONS
REVIEW QUESTIONS

1. When real GDP declines during a recession, what typically happens to consumption, investment, and the unemployment rate?

2. Give an example of a price that is sticky in the short run but flexible in the long run.

3. Why does the aggregate demand curve slope downward?

4. Explain the impact of an increase in the money supply in the short run and in the long run.

5. Why is it easier for the CB (Central Bank) to deal with demand shocks than with supply shocks?

6. An economy begins in long-run equilibrium, and then a change in government regulations allows banks to start paying interest on checking accounts. Recall that the money stock is the sum of currency and demand deposits, including checking accounts, so this regulatory change makes holding money more attractive.

   a. How does this change affect the demand for money?
   b. What happens to the velocity of money?
   c. If the CB keeps the money supply constant, what will happen to output and prices in the short run and in the long run?
   d. If the goal of the CB is to stabilize the price level, should the CB keep the money supply constant in response to this regulatory change? If not, what should it do? Why?
   e. If the goal of the CB is to stabilize output, how would your answer to part (d) change?

7. Suppose the CB reduces the money supply by 5 percent. Assume the velocity of money is constant.

   a. What happens to the aggregate demand curve?
   b. What happens to the level of output and the price level in the short run and in the long run? Give a precise numerical answer.
   c. In light of your answer to part (b), what happens to unemployment in the short run and in the long run according to Okun's law? Again, give a precise numerical answer.
   d. What happens to the real interest rate in the short run and in the long run? (Hint: Use the model of the real interest rate in Chapter 3 to see what happens when output changes.) Here, your answer should just give the direction of the changes.

8. Let's examine how the goals of the CB influence its response to shocks. Suppose that in scenario A the CB cares only about keeping the price level stable and in scenario B the CB cares only about keeping output and employment at their natural levels. Explain how in each scenario the CB would respond to the following.

   a. An exogenous decrease in the velocity of money.
   b. An exogenous increase in the price of oil.

9. Go to the http://www.evds2.tcmb.gov.tr and find the latest turning point in the business cycle.

   - When did it occur? Was this a switch from expansion to contraction or the other way around?
   - List all the recessions (contractions) that have occurred during your lifetime and the dates when they began and ended.