

**Intermediate Macroeconomics 311, Professor Larry Christiano**  
**Homework 4, due April 25, 2000, 2 PM**

**QUESTION 1**

Consider the model economy developed in Blanchard chapter 7. Assume that the money demand schedule is perfectly elastic with respect to the interest rate, i.e. horizontal, and in the other behavioral equations are:

$$\begin{aligned}C^d &= c_0 + c_1(Y - T) + gM/P, \\ I^d &= I - bi, \\ G^d &= G,\end{aligned}$$

and that aggregate supply is upward sloping in the short and medium run.

A) (2 points) In two **separate** AS-AD diagrams draw the AD curve so that we have short run equilibrium at the natural level of real GDP ( $Y^N$ ) for the case (i)  $g=0$ , and (ii)  $g>0$ .

B) (2 points) On the same diagrams show the new curves and equilibrium level of price and real GDP when there is an increase in money supply for cases (i) and (ii) above.

**QUESTION 2** (5 points)

Blanchard, page 147, question 5, points b-f.

**QUESTION 3** (1 point)

Blanchard, page 147, question 3, point b.

**Answer each point *graphically*, making sure you accurately label axis and curves.**