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ECON-1101
Homework Assignment #3
Due: April 6, 2022

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Chapter 11

Question #20- "What is on the horizontal axis of the AD/AS diagram? What is on the vertical axis?"

    The horizontal axis shows the real GDP (the level of GDP adjusted for inflation)
    The vertical axis shows the current price level.

Question #21- "What is the economic reason why the SRAS curve slopes up?"

    The economic reason why the SRAS curve slopes upward is for two reasons, sticky input prices and sticky output prices also called ("menu costs").

Question #22- "What are the components of the aggregate demand (AD) curve?"

    The four components of the aggregate demand curve are consumption, investment, government expenditures and net exports.

Question #23- "What are the economic reasons why the AD curve slopes down?"

    The curve slopes down because of the three reasons. The first reason is the wealth effect, this means as the price level rises, the value of money falls. The second reason is because of the interest rate effect, meaning as the price level rises, it requires more money to buy things. The third is the foreign price effect, meaning as the domestic price level rises, our exports become more expensive to foreigners, and imports from other countries are relatively cheaper to us. Because of this, imports fall and exports rise.

Question #26- "What is potential GDP?"

    Potential GDP is the highest sustainable level of real GDP that an economy can produce.

Chapter 12

Question #8- "Name some economic events not related to government policy that could cause aggregate demand to shift."

    Consumption, which is based on income. Investment which is based on future economic situations, and imports and exports.

Question #9-"Name some government policies that could cause aggregate demand to shift."

Increase in government spending will shift AD to the right while a decline in government spending demand will cause AD to shift to the left.

Question #10: "From a Keynesian point of view, which is more likely to cause a recession: aggregate demand or aggregate supply, and why?"

Aggregate demand because it can fall below potential GDP.

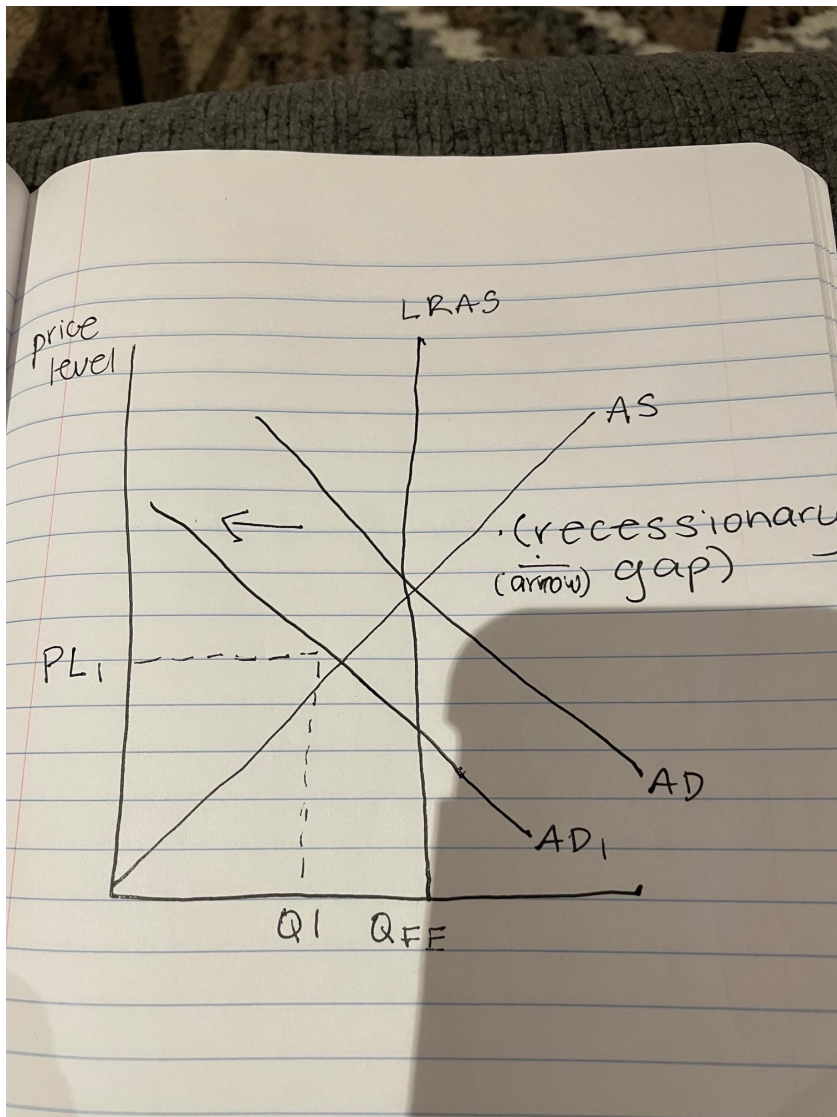Draw an AD/AS model diagram showing an economy in a recession. Briefly explain your diagram.

Diagram explained: The output (where we currently are) actual GDP is less than our potential GDP (our full employment GDP), this causes a recessionary gap.