1. Read chapter 24 from Hubbard and O’Brien, including its appendix.

2. Define “Aggregate Demand” “Aggregate Supply” and “Long-run Aggregate Supply” with one or two sentences each. Do not use the definitions in the book; provide your own definitions in a way anyone can understand.

3. Why does real consumption depend on the price level after controlling for real disposable income? (The answer is not “we want to consume less when prices are higher”.) (This question was also in HW4, now provide a better answer.)

4. Why is aggregate demand downwards sloping? (The answer is not “we demand less when prices are higher”) Why is aggregate supply upwards sloping? (The answer is not “producers supply more when prices are higher”) Why is long-run aggregate supply vertical?

5. Algebraically derive the aggregate demand curve from aggregate expenditure curves for different prices (i.e. take consumption as C=a+bDI-cP and derive the AD curve). Show the graphical equivalent and provide economic intuition in words. (This question was also in HW4, now provide a better answer.)

6. Trick question. GDP is C+I+G+X-IM. Aggregate demand is C+I+G+X-IM. Is the GDP equal to AD by definition?

7. Explain in your words why, if the supply curve is upward sloping and prices are not fixed, the multiplier will be smaller than the fixed price (horizontal supply) case.

8. Think about the following model where aggregate supply is given by

   \[ Y=250+25P \]

   and the components of aggregate demand are

   \[ C=209+0.9DI-10P \]
   \[ G=250 \]
   \[ T=10 \]
   \[ X=100 \]
Characterize the aggregate demand curve.

Find the equilibrium GDP and price level.

If potential GDP is 1500 is there a recessionary or inflationary gap? Is the labor market in equilibrium? Find the long-run equilibrium values of Y and P and describe the mechanism that will make the economy move from the short-run equilibrium to the long-run equilibrium.

If foreign demand on the domestic goods increases to 700, how much does the AD curve shift to the right? How much do the (short-run) values of Y and P change from their values in (b)? Why is/isn’t the change in Y the same as the shift in aggregate demand?

If the short-run equilibrium is as in (d), is there a recessionary or an inflationary gap? Describe the mechanism that will make the economy move from the short-run equilibrium to the long-run equilibrium.