Answers to Review Questions of Chapter 14

1) Analyze the effect of the following shocks on the interest rate, real output, the price level and real money balances
   i) the arrival of affordable electricity to major industrial areas around the turn of the century
   ii) the sharp but temporary increase in oil prices in the summer of 1990
   iii) an increase in the insecurity among firm owners and managers over the future state of the economy
   iv) the legal prohibition on nuclear energy that people perceive to be permanent
   v) a decrease in the money supply
   vi) the introduction and spread of credit cards

i)

\[
\begin{align*}
R & \quad \frac{1}{P} \\
Y^s \quad Y^s' & \quad Y^d' \\
Y^* \quad Y^* & \quad Y
\end{align*}
\]

\[
\begin{align*}
1/P & \quad M^d \\
1/P^* \quad 1/P^** & \quad M^d'
\end{align*}
\]

ii)

\[
\begin{align*}
R^* \quad \frac{1}{P} \\
Y^s' \quad Y^s & \quad Y^d \\
Y^* \quad Y^* & \quad Y
\end{align*}
\]

\[
\begin{align*}
1/P & \quad M^d \\
1/P^* \quad 1/P^** & \quad M^d'
\end{align*}
\]
2) We recently heard on the street "When prices rise it's just bad, real bad! I don't want to pay higher prices." Comment.

This is an understandable sentiment, but the speaker is ignoring the fact that the prices of the goods he or she sells are also going up.