

Macroeconomic equilibrium and stock market boom

[Finance](#), [Market](#)



Long-run Macroeconomic Equilibrium and Stock Market Boom

Let us assume the economy reaches its long-run macroeconomic equilibrium in 2020. When the economy is in the long run macroeconomic equilibrium, the stock market will also reach its boom. This will in turn lead to increases in stock prices more than expected, and the stock prices will stay high for some period. Answer the following questions based on the scenarios of long macroeconomic equilibrium and consequent stock market boom.

B) Which curve will shift? Is it AS curve or AD curve? In which direction does the shift occur? The aggregate demand curve will shift right b) In the short-run, what will happen to the price level and output (real GAP)? In the short run both the price level and real GAP will rise.

C) What will happen to the expected price level? What impact does this have on wage bargaining power of workers? The expected price level rises and the bargains are struck for higher wages.

D) In the long-run, which curve will shift due to the change in price expectations created by the stock market boom? In which direct will it shift? It will shift the short run aggregate supply curve to the left.

E) How does the new long-run macroeconomic equilibrium differ from the original equilibrium? The price level is higher and real GAP is the same.

2) Studies indicate that net exports and net capital outflows tend to be equal.

A) Why are net exports and net capital outflows tend to be equal? How does an increase in the price level change interest rates?

The value of produced in any country is always equal to the value of reciprocal Macroeconomic Equilibrium and Stock Market Boom: Unit 8 Answers By multidimensionality alee is also equal to the total amount currency traded in the foreign exchange market over that year, because the buyers in other countries trade in their assets to convert to equivalent amount in the country's currency, and use this amount to pay for the export products. Interest is the cost of holding money. The more you expect money to be devalued (inflation), the more interest compensation will be demanded.

) How does this change in interest rates lead to changes in investment and net exports? If interest rates were to rise generally businesses would invest less because the cost of borrowing money increases and would invest more if they were to lower the interest rates. Furthermore it affects net exports if it increases because it makes loan available to industries at higher rate so profit margin decreases and this adversely affects export and attracts more foreign investors in bonds/ deposits so currency improves and thus earnings from exports increases and cost of imports decreases.

Decreasing the interest rate would make loans available to industries at lower rate so profit margin increases and this improves export but discourages more foreign investors in bonds/ deposits so currency depreciates and then the earnings from exports decreases and cost of imports increases.

3) Assume there is a decrease in the demand for goods and services, which leads to a decrease in the real GDP and eventually the economy into recession.

A) When the economy enters recession due to a decline in demand, what will happen to the price level?

Output and input prices generally fall during recession, while the inflation rate rises during a boom and falls during a recession, it generally does not go below zero due to a consistently increasing money supply.

B) Assume there is no government intervention. What will ensure that the economy still eventually gets back to the natural rate of output (real GDP)? A decrease in aggregate demand causes the price level to fall. If the government takes no action to counter this, then the actual price level will be below the price level that people expected.

Individuals will eventually correct their expectations of the price level. As they do so, prices and wages will adjust accordingly, shifting the aggregate supply curve to the right. For example if wages are sticky, in light of the lower price level, firms and workers will eventually make bargains for lower nominal wages. The reduction in wages lowers costs of production, so firms are willing to produce more at any given price level. Consequently, the short-run aggregate supply curve shifts right. The rightward shift in aggregate supply eventually causes output to rise back to the natural rate.

C) A number macroeconomic variables decline during recessions.

One of these variables is the GAP.

A) What other variables, besides real GAP, tend to decline during recessions?

Given variables which are to be expected. Variables that fall along with real GAP include employment, incomes, investment, sales, and home purchases.

GAP may be measured as either the production of, expenditures on, or income generated from final goods and services. It follows that any other variable that could be used to measure production, expenditures, or income will generally move in the same direction as GAP.

B) Empirical studies indicate that the long-run trend in real GAP of the USA has an upward trend. How is this possible given business cycles and macroeconomic allocations? What factors explain the upward trend in spite of the cycles? Besides GAP, during recessions, income, profits and investment declines. The price level of goods and services declines during recessions. The aggregate demand and supply also declines and so does consumer spending and levels of employment. During a recession, the price levels of goods are lower than that expected.

This prompts supply to decline since the profits are low. Thus the aggregate supply goes down triggering a decline in employment levels. This in turn, makes consumers cautious and they tend to save rather than spend resulting in decline in the aggregate demand one of the factors to cause the upward spike is the war.

5) Assume there are short-run and long-run Macroeconomic Equilibriums in the economy. Refer to the AS and AD curves above to answer the following questions.

A) What is the initial point of the long-run macroeconomic equilibrium? What are the equilibrium values?

What does the appearance of the long-run aggregate-supply (LARS) curve indicate? How does it differ from AS? The long-run equilibrium of the economy is found where the aggregate-demand curve crosses the long-run aggregate-supply curve (point A). When the economy reaches this long-run equilibrium, the expected price level will have adjusted to equal the actual price level. As a result, the short-run aggregate-supply curve crosses this point as well.

B) What are the factors that can shift short-run aggregate supply curve from AS₁ to AS₂? What does Point A represent in the graph?

What does point B represent? Is it the short-run or long-run macroeconomic equilibrium? Explain. Shifts in the AS curve can be caused by the following factors: changes in size ; laity of the labor force available for production, changes in size ; quality of capital stock through investment, technological progress and the impact of innovation , changes in factor productivity of both labor and capital, changes in unit wage costs (wage costs per unit of output) , changes in producer taxes and subsidies boost wage levels and cause AS to shift inwards.

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Point A represents long run equilibrium because long-run equilibrium of the economy is found where the aggregate-demand curve crosses the long-run aggregate-supply curve Point B represents short-run equilibrium this is when the economy when the quantity demanded of Real GDP equals the (short-run) quantity supplied of Real GDP, where the aggregate demand curve intersects the short-run aggregate supply curve.

C) Assume aggregate demand (AD) is held constant, in the long-run, starting from point B, what will the economy likely experience? Will it reach the long equilibrium? In the long run the economy will experience a rising price level and a falling level of output. It will not reach long equilibrium because Long-run equilibrium occurs at the intersection of the aggregate demand curve and the long-run aggregate supply curve.