Macroeconomics

Literature, Russian Literature

Macroeconomics By a. The contractionary gap refers to an economy that has not reached full employment equilibriums. Given that the labor resource is underutilized, there is a low level of gross domestic product in such an economy. After the fall in the planned investment results to an increase in the contractionary gap that is similar to the multiplier.

b. To be able to restore the economy to full employment; the government must find ways that it promotes local businesses. When local businesses experience a high demand from their products they increase their labor requirement so that they can maximize the output. The government therefore has to increase their purchases of these products to the same amount as that planned for reduction in the investment spending.

c. A change in taxes can produce the same result. This is because taxes affect the production of companies. When taxes are reduced, companies can use that money elsewhere such as for investment purposes, they will also be motivated to increase their production as they will be paying lower taxes.

d. In a balanced budget economy law makers have to be very keen on the fiscal policies that they put in place so as to restore the economy to full employment. The most feasible way this can be done is by taking of loans to invest in other areas that will be repaid over time.

A graph showing the contractionary gap

The blue line in the graph represents the total demand. The red line in the graph represents the total supply of goods and services. The black line represents the economy's capacity in the long run. The equilibrium where they intersect is the potential output.

At a, the output is lower than the potential input. This means that the

economy is slow in the short term.

2.

a) When people buy goods and services using money the money is handed over to the stores who in turn pay their suppliers. The money circulates in the economy and is used by various people. The money supply is therefore maintained. When people use credit banks to pay for their shopping, there is no money that exchanges hands. This leads to a decrease in the money supply in the economy.

b) To reduce money supply the bank should increase lending rates. Higher rates mean that fewer people will be willing to borrow money from the bank and over time, there will be a decrease in the money supply within the economy.

3.

Cd = Ip

14400 + 0. 5(Y-T)-40000r = 8000- 20000r

14400- 8000+0. 5(Y-T) = -20000r+40000r

6400+0. 5(40000-T)= 20000r

6400+20000-0. 5T= 20000r

26400-0. 5T= 20000r

26400-0. 5T-20000r= 0

0. 5T+20000r= 26400

b.

0. 5T+20000r= 26400

0. 5(8000)+2000r= 26400

4000+2000r= 26400

20000r= 26400-4000

20000r= 22400

r= 1. 12%

4.

A. i) The purchasing power parity theory is concerned with the exchange rates (Blaug, 2006). Therates of exchange between two currencies are at equilibrium as long as their domestic purchasing power at a given exchange rate is equal. In this case, Gold should cost the same in both Mexico and U. S after taking into account the interest rate.

ii) When the price of the gold rises in Mexico due to inflation the product becomes cheaper in the United States and people will cross over the birder to go get it cheaply. They will therefore exchange their currency for us dollars and this makes the dollar stronger than the Mexican pesos. The exchange rate for pesos will most probably go down.

B.

i). Demand = supply

30000-8000e = 25000 + 12000e

12000e + 8000e = 30000- 25000

20000e = 5000

e = 0. 25(Market equilibrium value)

ii). When the pesos is fixed at 0. 30 dollars then it is overvalued. Countries will not readily trade using it and as a result will use other denominations. The reserves for the other international currencies will thereforedecrease while reserve for the peso will increase.

Bibliography:

BLAUG, M. (2006). Economic theory in retrospect. Cambridge, Cambridge University Press.