Macroeconomics: questions and answers assignment

Economics

As inflation rate increases sharply, the price level also increases sharply, causing the real value of money that the holders have to decrease. Why is wealth that IS held in savings account not subject to a change in the inflation tax? Due to the Fisher effect, the bank has already taken inflation rate into consideration. For example, if the bank posts a nominal interest rate of 7%, and the inflation rate is 3%, the real value of the deposits grows by 4% per year. The wealth that is held in savings account is not physical cash due to the money multiplier, thus the value of this money does not decrease. It is not a real variable, according to the monetary neutrality.

Nominal interest rate -?? Real interest rate + Inflation rate Question 2 Suppose that Australian expect inflation to equal 6 per cent in 201 5, but in fact price rise by only 3 per cent. How would this unexpectedly low inflation rate help or hurt the following? (0. 5 mark for each) a) The federal government This unexpectedly low inflation will hurt the federal government due to collecting a lower tax revenue. This may lead to the government printing more money to pay for their spending.) A homeowner with a fixed-rate mortgage This unexpectedly low inflation will help the homeowner with a fixed-rate Ortega as it meant that they pay less for the real interest rate, assuming that the nominal interest remain constant. Real interest rate (I) Nominal interest rate – Inflation rate (T) c) A worker with a 5-years fixed term wage contract This unexpectedly low inflation will help the worker because the worker’s purchasing power is higher. For example, with a $50 bill he can purchase more items when the inflation rate is at 3% instead of 6%.) A casual worker who has no labor contract This unexpectedly low inflation will help the worker, as it meant that they are heaper to hire. Thus, the company will continue to hire them, regardless of a labor contract, keeping them employed. E) A private school that has invested some of its endowment in Government Bonds. This unexpectedly low inflation will hurt the private school, as the nominal interest rate is lower than expected. This meant that they will earn less revenue from the government bonds.

Nominal interest rate (J) = Real interest rate + Inflation rate (1) 2 Question 3 a) ‘ In the long run, “ money is neutral. ” (ii) The long-run aggregate supply curve is vertical Changes in the supply of money affect nominal variables, but not real variables. B) Firms and workers often reach agreements under which nominal wages are “ sticky’ for periods as long as one or two years. (iii) The short-run aggregate supply curve slopes up An increase in the inflation rate, increases the quantity of goods and services supplied in the short run.

The wages do not adjust immediately to the inflation rate, due to the agreements that fixed the wages for up to one or two years. 3 c) When the price level rises, the real value of savers’ monetary wealth declines. I) The aggregate demand curve slopes down The nominal value of money is fixed, but the real value is not. When inflation rises, these dollars are less valuable because they can now be used to buy less goods and services. D) Some firms face “ menu costs” that cause them to change their output prices infrequently.