Answers to Questions for Review

23.1  (a) 5%.

(b) 2%.

(c) The rise in demand will raise prices, so people will expect a higher inflation rate than next year and the short-run Phillips curve will shift upwards.

(d) No. This depends on what people think will happen to demand in the following year, so answering it needs information beyond that given.

(e) It will shift upwards, for reasons outlined in the case of a different supply shock in Figure 23.10.

23.2  (a) The new classical economist would expect the labour market to return very quickly to equilibrium with unemployment back at the natural rate, and would see no need for demand management policies.

(b) The new monetarist economist would expect the labour market to return fairly quickly to equilibrium, and would see little case for altering aggregate demand, especially as the policies would have a lag which might mean they kicked in when demand was already picking up; also, fiscal policy would be expected to have little effect while expanding the money stock would threaten to increase inflation in future.

(c) The new Keynesian economist would advocate raising demand with fiscal policy and, using a Taylor rule, with some expansion in the money stock.