

Finance 30220
Quiz #6

Name _____

1) Real Business Cycle theory assumes that recessions and expansions are caused by temporary changes in productivity.

a) Suppose that the US experiences a temporary rise in productivity. Explain the impact of this on real wages, employment, and output.

This temporary rise in productivity should increase the demand for labor – labor demand shifts rightward, labor supply doesn't move, real wages rise and employment rises.

b) Given your answer to (a), what would be the impact on savings, investment, and the interest rate?

This productivity improvement is only temporary, so investment demand doesn't change, but with a temporary increase in income, household savings rises – savings shifts to the right, investment doesn't move, the interest rate falls and savings and investment rises.