

**Finance 30220**  
**Quiz #7**

Name \_\_\_\_\_

- 1) Real Business Cycle theory assumes that recessions and expansions are caused by changes in productivity. Suppose the economy experiences a 10% decline in productivity. Assume that this decline in productivity is temporary.

- a) Explain the impact of this drop in productivity on the FE curve.

*FE shifts to the left.*

- b) Explain the impact of this drop in productivity on the IS curve.

*IS Doesn't shift.*

- c) Explain the impact of this drop in productivity on the LM curve.

*The drop in productivity has no impact on the LM curve*

- d) Given the answers from (a) – (c), what will be the short term impact on interest rates and output?

*In the short term nothing happens, eventually, interest rates fall and output falls.*

- e) What will the long term impact on prices be?

*In the long term, prices rise*