

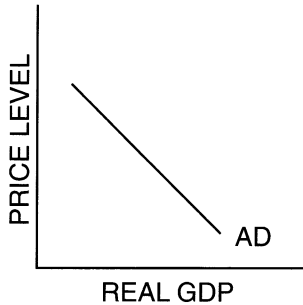
## Manipulating the AD and AS Model: Exogenous Demand and Supply Shocks

### Part A

#### Exogenous Demand Shocks

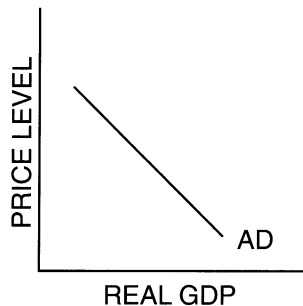
An *exogenous demand shock* is a change in an exogenous variable — a variable determined outside the model — that affects aggregate demand. Read the description of each exogenous demand shock, and then draw a new AD curve that will represent the change the demand shock caused. Label the new curve  $AD_1$ . Then briefly explain the reason for the change in the graph.

1. **Exogenous Demand Shock:** Economic booms in both Japan and Europe result in massive increases in orders for exported goods from the United States.



EXPLANATION:

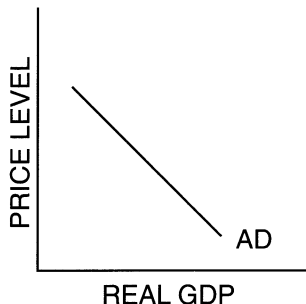
2. **Exogenous Demand Shock:** As part of its countercyclical policy, the government both reduces taxes and increases transfer payments.



EXPLANATION:

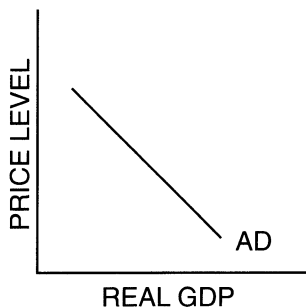
3. **Exogenous Demand Shock:** While the United States was in the midst of the Great Depression, a foreign power attacked, Congress declared war and more than 1,000,000 soldiers were drafted in the first year while defense spending was increased several times over.

EXPLANATION:



4. **Exogenous Demand Shock:** To balance the budget, the federal government cuts Social Security payments by 10 percent and federal aid to education by 20 percent.

EXPLANATION:

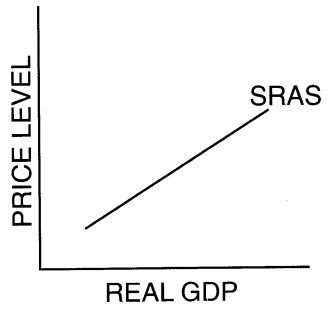


## Part B Exogenous Supply Shocks

The cause of an *exogenous supply shock* is the change in an exogenous variable — a variable determined outside the model — that affects aggregate supply. Read the description of each exogenous shock to short-run aggregate supply, and then draw a new SRAS curve that will represent the change caused by the shock. Label the new curve  $SRAS_1$ . Then briefly explain the reason for the change in the graph.

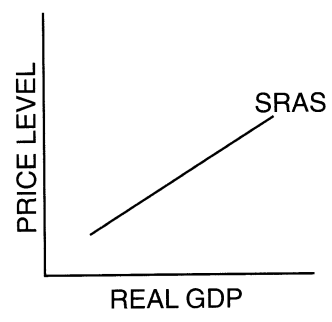
- 5. **Exogenous Supply Shock:** New environmental standards raise the average cost of autos and trucks 5 percent.

EXPLANATION:



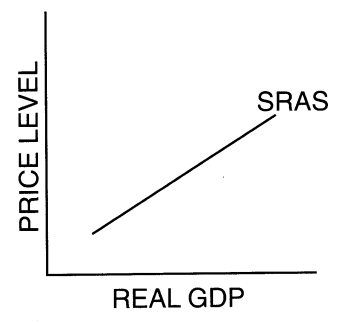
- 6. **Exogenous Supply Shock:** Fine weather results in the highest corn and wheat yields in 40 years.

EXPLANATION:

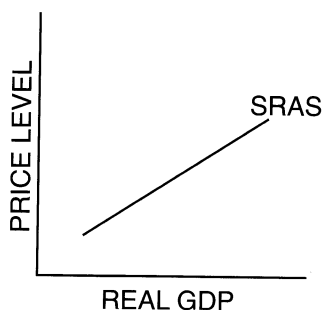


- 7. **Exogenous Supply Shock:** Because of decreased international tension, the government sells off thousands of army-surplus Jeeps and trucks at prices that are far less than the market price for their commercial counterparts.

EXPLANATION:



8. **Exogenous Supply Shock:** An enemy power sets up a blockade of the sea lanes leading to a country, and most ships refuse to deliver cargo through the blockade.



EXPLANATION:

**Part C**

**Manipulating the Aggregate Supply and Demand Model**

Read each of the scenarios below, and explain the impact the exogenous shocks will have on short-run aggregate supply and aggregate demand. Then draw a correctly labeled aggregate demand and aggregate supply graph to illustrate each short-run impact.

9. During a long, slow recovery from a recession, consumers postponed major purchases. Suddenly they begin to buy cars, refrigerators, televisions and furnaces to replace their failing models.
10. With no other dramatic changes, the government raises taxes and reduces transfer payments in the hope of balancing the federal budget.

