1. *The Problem:*

*Because of your economics knowledge, your family asks you to explain a graph that they saw in the newspaper over break. Specifically, they ask you to explain why consumer confidence matters and the channels through which it affects economy.*

Consumer confidence affects the level of autonomous consumption. When consumer confidence drops consumption decreases shifting the AE curve left leading to a decrease in output. As the economy moves down the Output Phillips curve inflation decreases if the central bank holds the policy rate constant.

AE1

AE2

r chosen by central bank

PC1

Y

Inflation

Y

r

Equilibrium Y

*Follow up question for groups that finish the exercise earlier than their peer groups.*

*Describe the way central bank policy makers may react to this information.*

Central bank policymakers may decide to lower interest rates in response to increase output.

1. *The Problem:*

*You are working as a manager for the Ritz-Carlton hotel chain. Your boss sees the following graph while surfing the Internet and she asks you to explain what it means. (Note: net equity extraction refers to home equity.) Explain what this graph means for consumption of hotel services and the channels through which it affects economy.*

Since homeowners have lost access to home equity their expenditures on hotel services will be lower. In addition, banks will be less willing to lend because the value of collateral (homes) is now lower. The AE curve shifts to the left lowering output if there is no change in central bank policy. The decrease in output moves the economy along the Output Phillips curve to a lower inflation rate.

AE1

AE2

r chosen by central bank

PC1

Y

Inflation

Y

r

Equilibrium Y

*Follow up question for groups that finish the exercise earlier than their peer groups.*

*Describe the way central bank policy makers may react to this information.*

Central bank policymakers may decide to lower interest rates in response to increase output.

1. *The Problem:*

*Over your summer break you are working a as lifeguard. Your fellow lifeguards are trying to decide whether to start a pool cleaning business. To open their business they will need a loan from a bank and have recently seen this graph in the WSJ. They ask you to explain what this graph means for the likelihood of getting a loan and the channels through which it affects economy.*

The increase in loans indicates that the credit crunch is easing and it makes it more likely that your fellow lifeguards will get a loan. More loans indicate investment spending is rising which shifts the AE curve to the right increasing output. The economy moves along the Output Phillips Curve and inflation rises.

AE1

AE2

r chosen by central bank

PC1

Y

Inflation

Y

r

Equilibrium Y

*Follow up question for groups that finish the exercise earlier than their peer groups.*

*Describe the way central bank policy makers may react to this information.*

Central bank policy makers may decide to raise interest rates to lower inflation.