

## Macro Mod 21 Homework

(The attached PDF file has better formatting.)

### Price mis-perceptions model (Chapter 15)

Choosing among macroeconomic models is not easy. GDP, unemployment, and interest rates are affected by so many variables that the effects of monetary policy are hard to discern. Many candidates find the reasoning in this chapter hard to follow. This homework assignment repeats Barro's analysis; you are not asked anything not in the text.

Empirically, the price level is counter-cyclical, the real wage rate is pro-cyclical, and the average product of labor is weakly pro-cyclical.

Part A: Explain why the price level is counter-cyclical, the real wage rate is pro-cyclical, and the average product of labor is pro-cyclical in Barro's equilibrium business-cycle model. Barro repeats the reasoning in this chapter, but you may want to refer also to the chapter on real business cycles.

Part B: Explain why the price level is pro-cyclical, the real wage rate is counter-cyclical, and the average product of labor is counter-cyclical in the price mis-perceptions model.

These relations are summarized in Table 19.1 on page 279. This homework assignment asks you to explain how Barro gets the relations. Write one paragraph for each part.