

THE UNIVERSITY OF ILLINOIS AT CHICAGO  
ECON 221: MACROECONOMIC THEORY  
SPRING 1998

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Your SSN: \_\_\_\_\_

**Homework 2**

The 1980 and the 1981-1982 Recessions [10 points].

(a) In 1979 there was an oil shock: oil prices almost doubled. Use the IS-LM-FE and AD-AS frameworks to predict the effects on interest rates, output, and prices. (b) In 1980-1981 monetary policy became contractionary and the government reduced taxes. Use the IS-LM-FE and AD-AS frameworks again to predict the effects on interest rates, output, and prices. (c) Consider the following U.S. data:

<u>Year</u>	<u>Real Output Growth</u>	<u>Inflation Rate</u>	<u>Real (short-term) Interest Rate</u>
1978	5.3%	7.8%	-0.1%
1979	2.5	11.2	1.0
1980	-0.2	13.5	2.1
1981	1.9	10.4	4.2
1982	-2.5	6.0	3.9
1983	3.6	3.2	5.1

Are these developments consistent with your predictions in parts (a) and (b)?