

### Workshop 5: Introduction to RBC Theory

For each of the parts below, discuss the questions within your individuals groups. Elect someone to report what your group concludes.

#### Part I: Questions from the Textbook

Please attempt the following questions:

Chapter 3: Numerical Problems (AB – pp 105 – 106)

Questions 1, 2, 4 and 5

Chapter 10: Numerical Problems (AB – pp 391 – 392)

Questions 1, 4 and 6.

Working with Macroeconomic Data:

Question 1.

#### Part II: Other Problems

Consider the following problems.

1. According to RBC theory, permanent and transitory shocks to technology should have very different effects on the economy.
  - a. Using the Robinson Crusoe story, compare the effects of:
    - A transitory shock (good weather expected to last only a few days)
    - Permanent shock (beneficial change in weather patterns)Which shock would have a greater effect on:
    - i. Crusoe's work effort?
    - ii. GDP?
  - b. Is it possible that one of these shocks might reduce work effort?
2. Suppose that prices are fully flexible and that output of the economy fluctuates because of shocks to technology, as RBC theories claim.
  - a. If the Fed holds money supply constant, what will happen to the price level as output fluctuates?
  - b. If the Fed adjusts the money supply to stabilize the price level, what will happen to the money supply as output fluctuates?
  - c. Many economists have observed that fluctuations in the money supply are positively correlated with fluctuations in output. Is this evidence against real business cycle theory?