Econ 305–Fall 2007
Problem Set 2
Posted: October 1
Due: October 8 IN CLASS

1 Question 1

Assume that a series of inflation rates is 1 percent, 2 percent, and 4 percent, while the nominal interest rates in the same periods are 5 percent, 5 percent, and 6 percent, respectively.

1.1

What are the *ex post* real interest rates in the same three periods?

1.2

If the *expected inflation* rate in each period is the *realized* inflation rate in the *previous* period (your expectation of the inflation rate for period 2 is given by the actual inflation in period 1 etc), what are the *ex ante* real interest rates in periods two and three?

1.3

If someone gets a loan in period two, based on the *ex ante* inflation expectation in period 3, will he or she be pleasantly or unpleasantly surprised?

2 Question 2

If the steady state rate of unemployment equals 0.125 and the fraction of workers who find jobs each month (the rate of job findings) is 0.56, then what is the fraction of employed workers who lose their jobs each month (the rate of job separations)? (Start from the basic model of unemployment we learned in class, find the rule for computing the natural rate of unemployment, and use that definition to calculate the rate of job separations.)