



**AP[®] Macroeconomics
2008 Free-Response Questions
Form B**

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2008 AP[®] MACROECONOMICS FREE-RESPONSE QUESTIONS (Form B)

MACROECONOMICS

Section II

Planning Time—10 minutes

Writing Time—50 minutes

Directions: You have 50 minutes to answer all three of the following questions. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. Use a pen with black or dark blue ink.

1. Assume that the economy of Country Z is operating on the upward-sloping portion of its short-run aggregate supply curve. Assume that the government increases spending.
 - (a) How will the increase in government expenditures affect each of the following in the short run?
 - (i) Aggregate demand
 - (ii) Short-run aggregate supply
 - (b) Using a correctly labeled graph of aggregate demand and aggregate supply, show the effect of the increase in government expenditures on real output and the price level.
 - (c) Assume that the government funded this increase in expenditure by borrowing from the public. Using a correctly labeled graph of the loanable-funds market, show the effect of the increase in government borrowing on the real interest rate.
 - (d) Given the change in the real interest rate in part (c), what will be the effect on each of the following on the foreign exchange market?
 - (i) Supply of Country Z's currency. Explain.
 - (ii) The value of Country Z's currency
 - (e) Given your answer in part (d) (ii), what will be the effect of the change in the value of Country Z's currency on Country Z's exports? Explain.

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2. Suppose that Mexico decreases its tariff rates on all of its imports of automobiles from abroad.
- (a) Will each of the following groups benefit from the decrease in the tariff rate?
 - (i) Mexican consumers
 - (ii) Mexican automobile manufacturers. Explain.
 - (b) How would the decrease in the tariff rates affect each of the following in Mexico?
 - (i) Current account balance. Explain.
 - (ii) Capital account balance
 - (c) Given the change in Mexico's current account in part (b)(i), what will happen to the aggregate demand in Mexico?

OUTPUTS AND PRICES IN GALA LAND

This Year's Output	This Year's Price
400 loaves of bread	\$6 per loaf
1,000 gallons of water	\$2 per gallon
800 pieces of fruit	\$2 per piece

3. Gala Land produces three final goods: bread, water, and fruit. The table above shows this year's output and price for each good.
- (a) Calculate this year's nominal gross domestic product (GDP).
 - (b) Assume that in Gala Land the GDP deflator (GDP price index) is 100 in the base year and 150 this year. Calculate each of the following.
 - (i) The inflation rate, expressed as a percentage, between the base year and this year
 - (ii) This year's real GDP
 - (c) Since the base year, workers have received a 20 percent increase in their nominal wages. If workers face the same inflation that you calculated in part (b)(i), what has happened to their real wages? Explain.
 - (d) If the GDP deflator in Gala Land increases unexpectedly, would a borrower with a fixed-interest-rate loan be better off or worse off? Explain.

STOP

END OF EXAM