

2. Assume the expected inflation rate in a country is 3%, the current unemployment rate is 6%, and the natural rate of unemployment is 4%.
- (a) Draw a correctly labeled graph of the short-run and long-run Phillips curves. Label the current short-run equilibrium as point X and plot the numerical values above on the graph.
 - (b) Is the actual inflation rate greater than, less than, or equal to the expected inflation rate of 3%?
 - (c) Assume loans were made taking into account the expected inflation rate of 3%. Will lenders be better off or worse off after they realize the actual inflation rate identified in part (b) ? Explain.
 - (d) Based on the relationship between the actual and the expected inflation rates identified in part (a), what will happen to the natural rate of unemployment in the long run?
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3. Assume that households in Econland increase their savings for retirement.
- (a) Using a correctly labeled graph of the loanable funds market, show how the increase in savings will affect the equilibrium real interest rate.
 - (b) Based solely on the real interest rate change identified in part (a), what will happen to Econland's purchases of foreign assets? Explain.
 - (c) Consider the foreign exchange market for Econland's currency.
 - (i) Based on your answer to part (b), what will happen to the international value of Econland's currency?
 - (ii) Based on your answer to part c (i), would Econland's central bank buy or sell its currency in the foreign exchange market to offset the change in the value of its currency?

STOP

END OF EXAM