2. Assume the economy of Jenland is in short-run equilibrium at a real output level above full-employment real output.

A. The banking system in Jenland has ample reserves. Identify a specific monetary policy action that the central bank of Jenland would implement to return the economy to full employment in the short run.

B. Draw a correctly labeled graph of the reserve market for Jenland, and show the effect of the central bank's action identified in part A on the policy rate.

C. Based on the change in the interest rate shown on your graph in part B, will each of the following increase, decrease, or remain the same in Jenland in the short run?

i. The price of previously issued bonds

ii. The price level. Explain.

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2. Assume the economy of Ucheland is currently at full employment. The government of Ucheland reduces the tax rate on household interest earnings.

(a) What will happen to private savings in Ucheland?

(b) Draw a correctly labeled graph of the loanable funds market, and show the effect of the change in private savings identified in part (a) on the equilibrium real interest rate.

(c) Given the real interest rate change identified in part (b), answer the following questions.

(i) What is the short-run effect on aggregate demand? Explain.

(ii) What is the long-run effect on potential real gross domestic product in Ucheland? Explain.