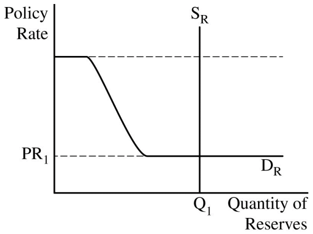
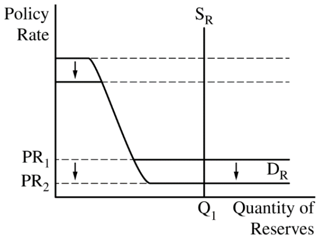
Question 2: Short — 5 points

A Point 1	State that the central bank of Country L would buy bonds.	**1 point**
B Point 2	State that the central bank of Country A would decrease its administered interest rates or decrease interest on reserves.	**1 point**
C Point 3	Draw a correctly labeled graph of the reserve market with the supply curve intersecting the demand curve in the range of ample reserves.	**1 point**

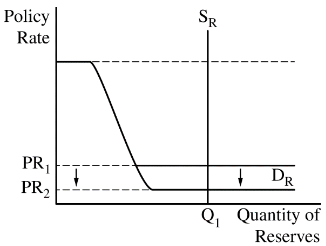


Point 4	The graph must show a decrease in the administered interest rates, resulting in a decrease in the policy rate.	**1 point**



OR

The graph must show a decrease in the lower bound of the demand curve for reserves, resulting in a decrease in the policy rate.



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D Point 5	State that short-run aggregate supply will increase until it reaches full employment and explain that the increase in short-run aggregate supply in the long run will be caused by a decrease in input prices (e.g., nominal wages) and/or inflationary expectations.	**1 point**

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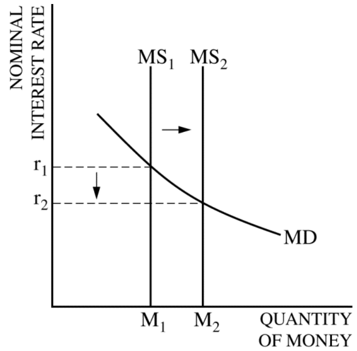
Question 2

6 points (2+2+1+1)

(a) 2 points:
- One point is earned for stating that the Federal Reserve will buy government bonds.
- One point is earned for stating that the price of government bonds will increase.



(b) 2 points:
- One point is earned for drawing a correctly labeled graph of the money market.
- One point is earned for shifting the money supply curve to the right and showing a decrease in the nominal interest rate.

(c) 1 point:
- One point is earned for stating that the Federal Reserve purchase will not initially affect commercial banks' required reserves.

(d) 1 point:
- One point is earned for defining the discount rate as the interest rate that the Federal Reserve charges banks for borrowing from its discount window.

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