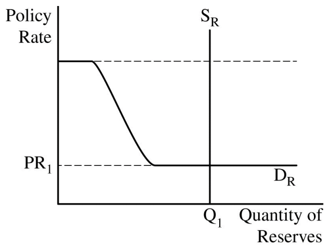
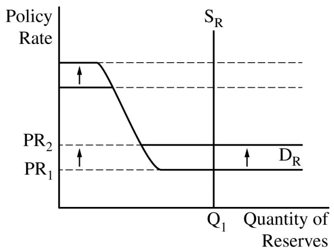
Question 2: Short — 5 points

A — Point 1 — State that the central bank would increase its administered interest rates or increase interest on reserves. — **1 point**

B — Point 2 — 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**

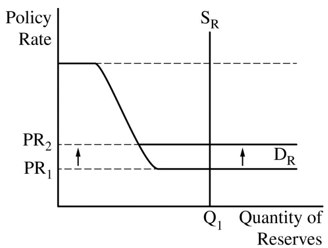


Point 3 — The graph must show an increase in the administered interest rates, resulting in an increase in the policy rate. — **1 point**



OR

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



C (i) — Point 4 — State that the price of previously issued bonds will decrease. — **1 point**

(ii) — Point 5 — State that the price level will decrease and explain that the increase in interest rates will decrease interest-sensitive spending (consumption, investment, or net exports), which will decrease aggregate demand. — **1 point**

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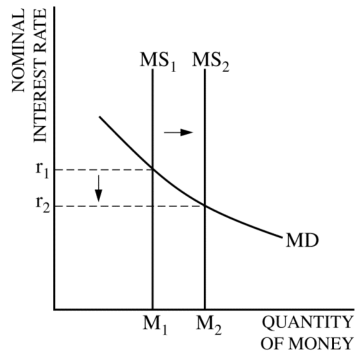
Question 2

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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