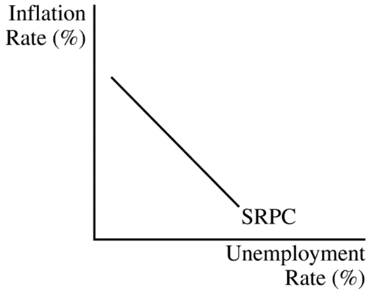
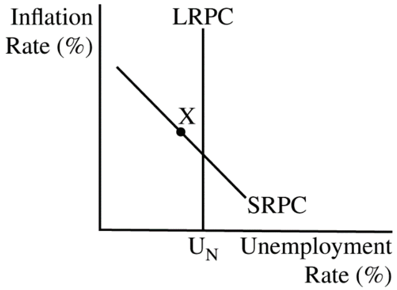
Question 2: Short — 5 points

(a) Draw a correctly labeled graph of the short-run Phillips curve (SRPC). **1 point**



For the second point, the graph must include a correctly labeled long-run Phillips curve (LRPC) and show point X on the SRPC to the left of the LRPC. **1 point**



Total for part (a) 2 points

(b) State that the central bank would increase its administered interest rates or increase interest on reserves. **1 point**

(c) State that there will be an increase in the flow of international financial capital into Noralandia and explain that international investors will seek higher returns on financial capital in Noralandia. **1 point**

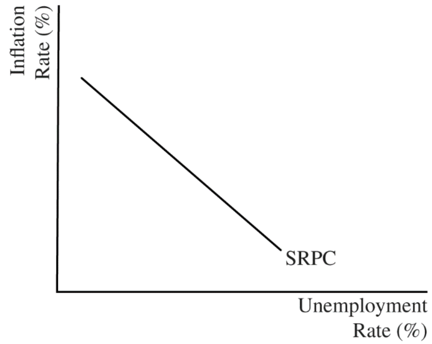
(d) State that Noralandia's currency will appreciate and explain there will be an increase in the demand for Noralandia's currency (or a decrease in the supply of Noralandia's currency). **1 point**

Total for question 2 5 points

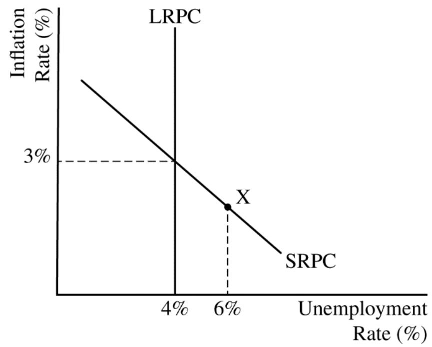
Question 2

5 Points (2 + 1 + 1 + 1)

(a) 2 points



- One point is earned for drawing a correctly labeled graph showing the short-run Phillips curve (SRPC).



- One point is earned for drawing the long-run Phillips curve (LRPC) showing the short-run equilibrium, labeled as point X, on the SRPC to the right of the LRPC, and for plotting the numbers in the correct places on the graph.

(b) 1 point

- One point is earned for stating that the actual inflation rate is less than the expected inflation rate.

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Question 2 (continued)

(c) 1 point

- One point is earned for stating that lenders will be better off and for explaining the real value of the loans that will be repaid will be higher than expected **OR** for explaining the relationship between the nominal and the real interest rates using the Fisher equation.

(d) 1 point

- One point is earned for stating that the natural rate of unemployment will not change in the long run.