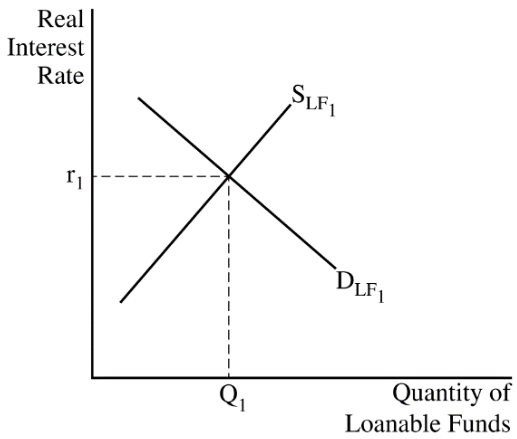
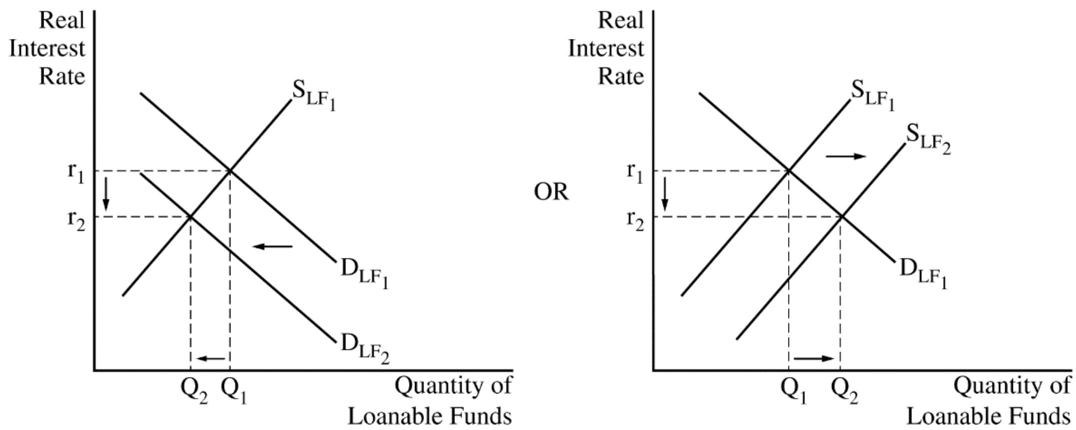
Question 3: Short — 5 points

(a) State increase taxes, decrease government spending, or decrease transfer payments. **1 point**

(b) Draw a correctly labeled graph of the loanable funds market. **1 point**



For the second point, the graph must show a leftward shift of the demand for loanable funds curve (or a rightward shift of the supply of loanable funds curve), resulting in a decrease in the real interest rate. **1 point**



Total for part (b) — 2 points

(c) (i) State that aggregate demand will increase and explain that interest-sensitive spending (consumption, investment, or net exports) will increase. **1 point**

(ii) State that potential real output will increase and explain that the decrease in the real interest rate means the cost of borrowing has decreased, which increases investment spending on plant and equipment and increases capital formation. **1 point**

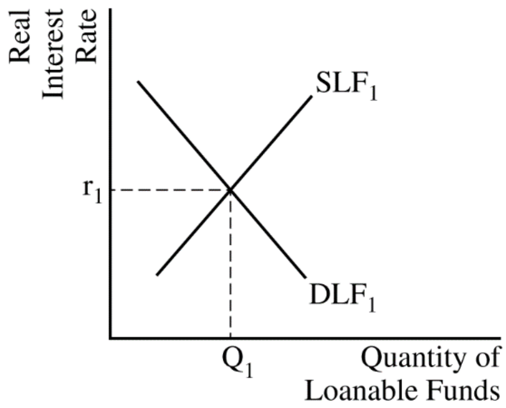
Total for part (c) — 2 points

Total for question 3 — 5 points

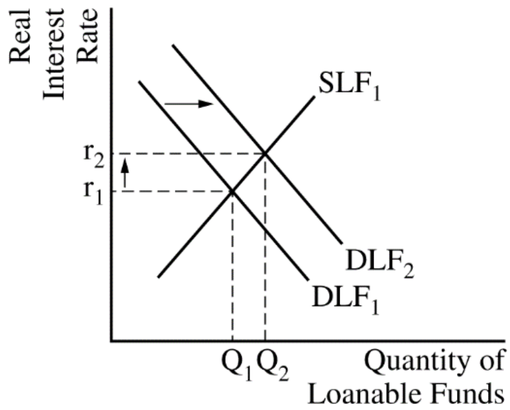
Question 2: Short — 5 points

(a) State that the country could implement one of the following fiscal policy actions: increase government spending, increase transfer payments, or decrease taxes. **1 point**

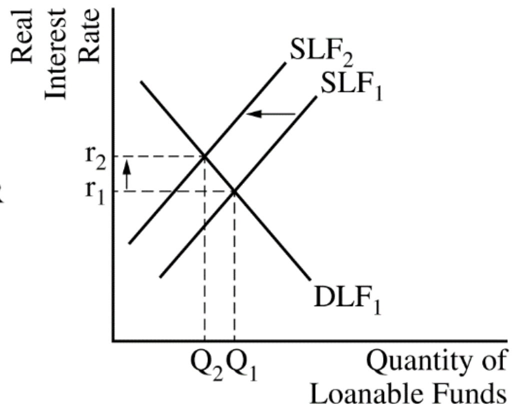
(b) Draw a correctly labeled graph of the loanable funds market. **1 point**



For the second point, the graph must show a rightward shift in the demand for loanable funds curve (or a leftward shift in the supply of loanable funds curve), resulting in an increase in the equilibrium real interest rate. **1 point**



OR



Total for part (b) — 2 points

(c) (i) State that net exports will decrease and explain that the increase in the real interest rate will increase the demand for the country’s currency, which will cause the country’s currency to appreciate and make domestic goods relatively more expensive than foreign goods, thereby decreasing exports. **1 point**

(ii) State that the stock of physical capital will decrease and explain that the increase in the real interest rate will discourage investment spending in physical capital. **1 point**

Total for part (c) — 2 points

Total for question 2 — 5 points