

2. The United States and South Africa are trading partners with flexible exchange rates, and the United States current account balance with South Africa is zero.
- (a) Assume real income in the United States increases while real income in South Africa remains the same. Will United States net exports increase, decrease, or remain unchanged? Explain.
- (b) Based on your answer to part (a), what will happen to each of the following?
- (i) The capital and financial account balance in the United States
 - (ii) Actual unemployment in South Africa in the short run. Explain.
- (c) The currency of the United States is the dollar (USD), and the currency of South Africa is the rand (ZAR). Draw a correctly labeled graph of the foreign exchange market for the rand and show the effect of the increase in real income in the United States on the international value of the rand.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

2. The European Union and the United States are trading partners.
- (a) If the current account balance is zero, will an increase in United States real income result in a current account surplus, deficit, or no change? Explain.
- (b) Draw a correctly labeled graph of the foreign exchange market for the euro. On your graph, show the effect of the increase in United States real income on the value of the euro relative to the United States dollar.
- (c) Now assume interest rates increase in the European Union.
- (i) What is the effect of the increase in interest rates in the European Union on the demand for the United States dollar? Explain.
 - (ii) Based on your answer to part (c)(i), what is the effect on the value of the United States dollar relative to the euro?