

2. The table provided shows economic data for the country of Louland. The base year is year 1, and the GDP deflator in year 2 is 115.

|             | Year 1  | Year 2    |
|-------------|---------|-----------|
| Nominal GDP | 800,000 | 1,035,000 |
| Population  | 1,000   | 1,200     |

- (a) Calculate real GDP in Louland in year 2. Show your work.
- (b) How would the change in real GDP from year 1 to year 2 affect the demand for money and the nominal interest rate in Louland?
- (c) Did the standard of living of the average citizen in Louland increase, decrease, or remain the same from year 1 to year 2 ? Explain using numbers.
- (d) What was the numerical value of the inflation rate from year 1 to year 2 ?
- (e) If nominal wages increased by 10% from year 1 to year 2, what happened to the real wages of workers in Louland during this time? Explain.

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 table provided shows the quantity and price of food and clothing, the only two goods produced and consumed in the country of Maltrose, in year 1 and year 2. Assume that year 1 is the base year.

|          | Year 1 Price | Year 1 Quantity | Year 2 Price | Year 2 Quantity |
|----------|--------------|-----------------|--------------|-----------------|
| Food     | \$10         | 12              | \$13         | 10              |
| Clothing | \$5          | 16              | \$4          | 20              |

- (a) Calculate the nominal GDP in year 2. Show your work.
- (b) Calculate the GDP deflator in year 2. Show your work.
- (c) What was the numerical value of the inflation rate from year 1 to year 2 ?
- (d) Assuming that the expected inflation rate between years 1 and 2 was 3%, were each of the following better off, worse off, or unaffected as a result of the economic conditions between year 1 and year 2 ?

(i) People living on a fixed income

(ii) Borrowers with fixed interest-rate loans. Explain.

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. Assume the expected inflation rate in a country is 3%, the current unemployment rate is 6%, and the natural rate of unemployment is 4%.
- (a) Draw a correctly labeled graph of the short-run and long-run Phillips curves. Label the current short-run equilibrium as point X and plot the numerical values above on the graph.
  - (b) Is the actual inflation rate greater than, less than, or equal to the expected inflation rate of 3%?
  - (c) Assume loans were made taking into account the expected inflation rate of 3%. Will lenders be better off or worse off after they realize the actual inflation rate identified in part (b) ? Explain.
  - (d) Based on the relationship between the actual and the expected inflation rates identified in part (a), what will happen to the natural rate of unemployment in the long run?
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