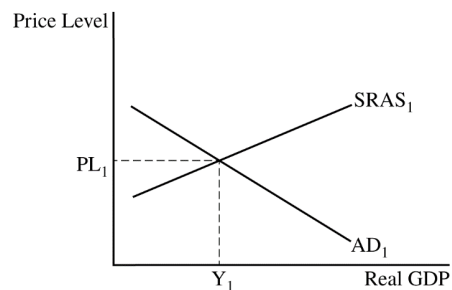
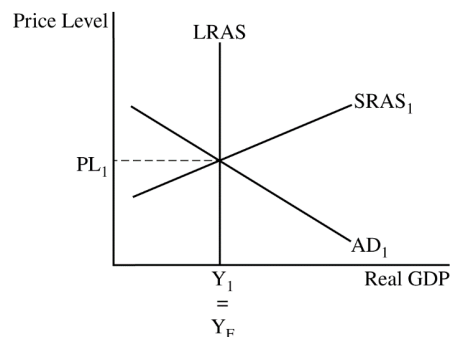


Question 3: Short**5 points**

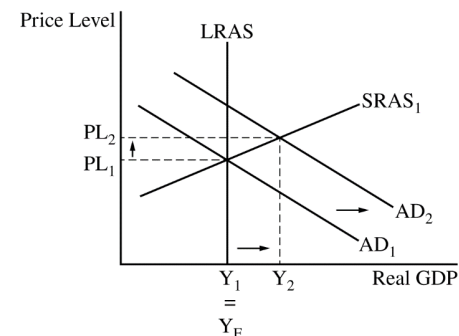
- A** Draw a correctly labeled aggregate demand–aggregate supply graph that shows PL_1 and Y_1 at the intersection of the aggregate demand (AD) and short-run aggregate supply (SRAS) curves. **1 point**
- Point 1



- Point 2 The graph must show a vertical long-run aggregate supply (LRAS) curve at equilibrium real output $Y_1 = Y_F$. **1 point**



- B** On the graph from part A, show the short-run effect of the increase in real income in Thailand as a rightward shift of Nepal's aggregate demand curve, resulting in an increase in real output, labeled Y_2 , and an increase in the price level, labeled PL_2 . **1 point**
- Point 3



- C** Calculate the minimum change in government spending as a decrease of 100 million rupees and show your work. **1 point**
- Point 4

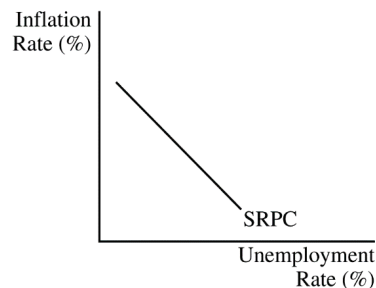
$$\text{Min Change} = \frac{-400 \text{ million rupees}}{1 - 0.75} = \frac{-400 \text{ million rupees}}{0.25} = -1600 \text{ million rupees}$$

- D** Explain that as real income rises, tax revenues will increase automatically (and/or transfer payments will decrease automatically), thereby slowing the rate at which disposable income is increasing, which will slow consumption growth. **1 point**
- Point 5

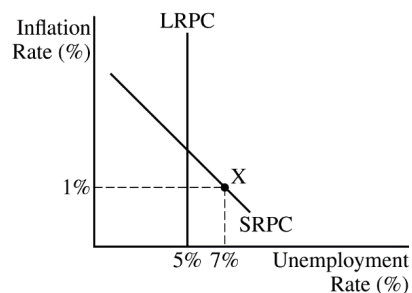
Question 1: Long

10 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 vertical long-run Phillips curve (LRPC) at the natural rate of unemployment (5%) and must include point X on the SRPC to the right of the LRPC at the actual unemployment rate (7%) and the actual inflation rate (1%). 1 point



Total for part (a) 2 points

- (b) State that the expected inflation rate is greater than 1% and explain that the actual unemployment rate (7%) is greater than the natural rate of unemployment (5%); or explain that the economy is in a recession. 1 point

- (c) (i) Calculate the maximum change in aggregate demand as \$180 billion and show your work. 1 point

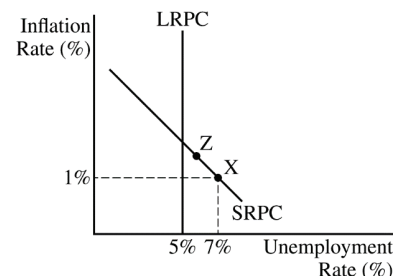
$$\text{Maximum } \Delta \text{ in AD} = -\$20 \text{ billion} \times \frac{-0.9}{1 - 0.9} = -\$20 \text{ billion} \times -9 = \$180 \text{ billion}$$

- (ii) Calculate the maximum change in aggregate demand as \$200 billion and show your work. 1 point

$$\text{Maximum } \Delta \text{ in AD} = \$20 \text{ billion} \times \frac{1}{1 - 0.9} = \$20 \text{ billion} \times 10 = \$200 \text{ billion}$$

Total for part (c) 2 points

- (d) On the graph from part (a), show point Z on the SRPC to the left of point X. 1 point



- (e) State that aggregate demand would increase and explain that the increase in disposable income would increase consumption spending. 1 point

- (f) (i) State that the short-run aggregate supply curve will shift to the right and explain that input prices (e.g., nominal wages) and/or inflationary expectations will decrease. 1 point

- (ii) State that the short-run Phillips curve will shift to the left. 1 point

- (iii) State that the actual unemployment rate will decrease. 1 point

Total for part (f) 3 points

Total for question 1 10 points

Question 3: Short

5 points

- (a) (i) State that the government budget will move into deficit in the short run and explain that tax revenues (T) will decrease and transfer payments (TR) will increase. 1 point

- (ii) State that the government debt will increase. 1 point

Total for part (a) 2 points

- (b) Identify an increase in taxes or a decrease in government spending. 1 point

- (c) State that the actual unemployment rate will increase in the short run and explain that aggregate demand will decrease, which will decrease real output. 1 point

- (d) State that the government's efforts to maintain a balanced budget made Geeland's recession more severe in the short run and explain that in order to maintain a balanced budget, the government had to implement contractionary fiscal policy during a recession. (It is also acceptable to explain that the government's efforts to maintain a balanced budget will decrease real output or aggregate demand and that unemployment will increase.) 1 point

Total for question 3 5 points