

1. Assume that the economy of Moneyland is in equilibrium with an actual unemployment rate equal to the natural rate of unemployment.
- (a) Draw a correctly labeled graph of the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves, and show each of the following.
- (i) The current equilibrium real output and price level, labeled Y_1 and PL_1 , respectively
 - (ii) The full employment output, labeled Y_F
- (b) Assume that consumer spending in Moneyland decreases from \$110,000 to \$100,000 as a result of a decrease in disposable income in Moneyland from \$135,000 to \$110,000.
- (i) Calculate the marginal propensity to consume in Moneyland. Show your work.
 - (ii) Show the short-run effect of the decrease in consumer spending in Moneyland on your graph in part (a), labeling the new equilibrium real output and price level Y_2 and PL_2 , respectively.
- (c) Following the decrease in consumer spending, explain how the economy would adjust in the long run in the absence of any policy actions.
- (d) The central bank of Moneyland is concerned about the short-run effects of the decrease in consumer spending on the broader economy and is considering taking action rather than waiting for the long-run adjustment process. Assuming the banking system in Moneyland has ample reserves, identify a specific monetary policy action the central bank of Moneyland would take to increase consumer spending.
- (e) Draw a correctly labeled graph of the reserve market in Moneyland, and show the effect of the monetary policy action identified in part (d) on the policy rate.
- (f) How would the change in the policy rate shown on your graph in part (e) affect each of the following in Moneyland in the short run?
- (i) The quantity of national savings
 - (ii) Unemployment. 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.

3. Assume that the economy of country Zen is in long-run macroeconomic equilibrium.
- (a) Draw a correctly labeled graph of the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves, and show each of the following.
- (i) The current equilibrium real output and price level, labeled Y_1 and PL_1 , respectively
 - (ii) The full-employment output, labeled Y_F
- (b) On your graph in part (a), show the short-run effect of an increase in consumer confidence. Label the new equilibrium real output Y_2 and the new equilibrium price level PL_2 .
- (c) Assume that the banking system in Zen has ample reserves. Suppose that the central bank's goal is to maintain a stable price level at PL_1 . Based on the change in the price level shown in part (b), identify one specific monetary policy action the central bank would take to achieve its goal.
- (d) Based on the monetary policy action identified in part (c), will real output increase, decrease, or stay the same in the short run? Explain.

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3. The government budget of the country of Geeland is currently balanced. The government budget is composed of tax revenues (T), transfer payments (TR), and government spending (G).
- (a) Assume the economy moves into a recession and there is no discretionary policy action.
- (i) Will the government budget move into a deficit or a surplus in the short run? Explain using the appropriate components of the government budget identified above.
 - (ii) Based on your answer to part (a)(i), what will happen to the government debt?
- (b) Based on your answer to part (a)(i), identify one specific fiscal policy action that will balance the budget.
- (c) How will the fiscal policy action from part (b) affect the actual unemployment rate in the short run? Explain.
- (d) Did the government efforts to maintain a balanced budget make Geeland's recession more severe or less severe in the short run? Explain.

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