

1. Assume that the economy of Vortania is in long-run equilibrium.

- A. Draw a correctly labeled graph of the short-run and long-run Phillips curves for the economy of Vortania, and label the long-run equilibrium point as P.
- B. Assume that new residential construction projects are being implemented in Vortania.
 - i. Will real output in Vortania increase, decrease, or remain the same in the short run? Explain.
 - ii. Assuming no change in inflationary expectations, on your graph in part A, show the short-run effect of the new residential construction projects on Vortania's economy, labeling the new short-run equilibrium point as S.
- C. Vortania and Rhodara are trading partners with flexible exchange rates. The currency of Vortania is the Vortanian crown (VTC), and the currency of Rhodara is the Rhodaran mark (RHM). Assume that Vortania's capital and financial account (CFA) balance is zero. Now assume that Vortania imposes new tariffs on imports from Rhodara. Draw a correctly labeled graph of the foreign exchange market for the Vortanian crown, and show the effect of the tariffs on the SUPPLY of the Vortanian crown and the international value of the Vortanian crown.
- D. Based solely on the change in the international value of the Vortanian crown shown in part C, will Vortania's net exports increase, decrease, or remain the same in the short run?
- E. Based on the change in net exports identified in part D, what will happen to each of the following in the short run?
 - i. The capital and financial account (CFA) balance in Vortania. Explain.
 - ii. Employment in Vortania
- F. Assume the central bank of Vortania wants to return the Vortanian crown to its international value before the imposition of the tariffs. Would the central bank buy or sell Vortanian crowns in the foreign exchange market? Explain.

3. Assume that Jamaica has a cyclical unemployment rate of 4% and a balanced capital and financial account (CFA).

- (a) Identify a specific fiscal policy action that Jamaica's government would take to bring its economy to full employment.
- (b) Based solely on the short-run change in real output resulting from the fiscal policy action identified in part (a), what will happen to Jamaica's net exports? Explain.
- (c) Assume that Jamaica and Turkey are trading partners with flexible exchange rates. Jamaica's currency is the Jamaican dollar (JMD), and Turkey's currency is the lira (TRY). Draw a correctly labeled graph of the foreign exchange market for the Jamaican dollar relative to the lira, and show the effect of the change in net exports identified in part (b) on the supply of the Jamaican dollar and the international value of the Jamaican dollar.
- (d) How will the change in net exports identified in part (b) affect Jamaica's capital and financial account (CFA)? 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.

STOP

END OF EXAM

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.

1. Assume the economy of Sweden is in long-run equilibrium and has a surplus in its current account.
- (a) Is the Swedish capital and financial account in deficit, in surplus, or in balance? Explain.
- (b) Draw a correctly labeled graph of short-run aggregate supply, long-run aggregate supply, and aggregate demand curves for Sweden, and show the current equilibrium real output, labeled Y_1 , and the current equilibrium price level, labeled PL_1 .
- (c) Assume the United Kingdom decreases its imports from Sweden. On your graph in part (b), show the new equilibrium real output, labeled Y_2 , and the new equilibrium price level, labeled PL_2 , as a result of this change.
- (d) As a result of the decrease in the United Kingdom's imports from Sweden, would policy makers in Sweden be more concerned about cyclical unemployment or inflationary pressures in the short run? Explain.
- (e) If the Swedish central bank's goal is to return the economy to long-run equilibrium, what open-market operation should it use?
- (f) The currency of the United Kingdom is the pound, and the currency of Sweden is the krona. Draw a correctly labeled graph of the foreign exchange market for the krona, and show the impact of the decrease in the United Kingdom's imports from Sweden on the value of the krona in the foreign exchange market.
- (g) If the Swedish central bank's goal is to reverse the exchange rate change shown in part (f) by changing the interest rate, what open-market operation should it use?
- (h) Explain how the open-market operation identified in part (g) would reverse the change in the exchange rate.

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?

2. The Federal Reserve can influence the supply of money.
- (a) Assume that the Federal Reserve targets a lower federal funds rate.
- (i) What open market operation can the Federal Reserve use to achieve the lower target?
- (ii) Given your answer to part (a)(i), what will happen to the price of government bonds?
- (b) Using a correctly labeled graph of the money market, show the effect of the open market operation from part (a)(i) on the nominal interest rate.
- (c) Assume that the Federal Reserve buys government bonds from commercial banks. Based only on this transaction, will the level of required reserves in the commercial banks increase, decrease, or remain the same?
- (d) Another monetary policy action involves changing the discount rate. Define the discount rate.
-
3. The United States and South Korea are trading partners, and the United States has a zero current account balance. Assume now that the inflation rate in the United States decreases relative to the inflation rate in South Korea.
- (a) Based on the decrease in the inflation rate in the United States, will United States exports to South Korea increase or decrease?
- (b) Based on the change in United States exports in part (a), answer each of the following.
- (i) Will the United States current account balance remain at zero, be in surplus, or be in deficit?
- (ii) What will happen to real gross domestic product in the United States in the short run? Explain.
- (c) The South Korean currency is the won. Draw a correctly labeled graph of the foreign exchange market for the United States dollar. Show the effect of the lower inflation rate in the United States on the won price per United States dollar.

STOP

END OF EXAM