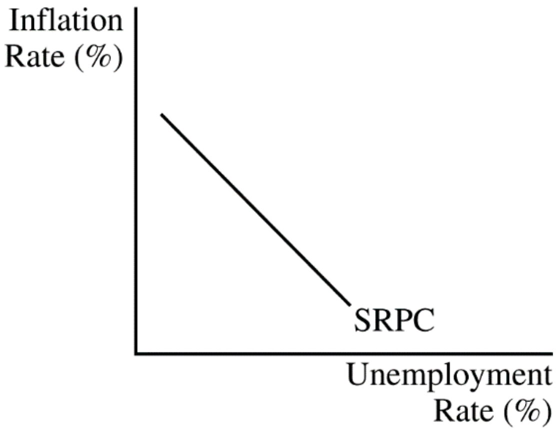
Question 1: Long — 10 points

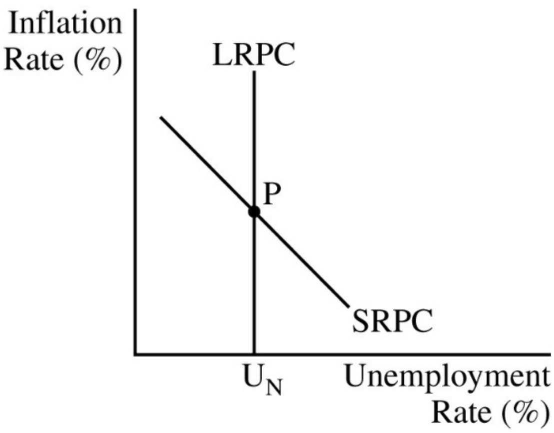
A Point 1

Draw a correctly labeled graph of the short-run Phillips curve (SRPC). **1 point**



Point 2

The graph must include a correctly labeled long-run Phillips curve (LRPC) and show a point labeled P at the intersection of the short-run and long-run Phillips curves. **1 point**

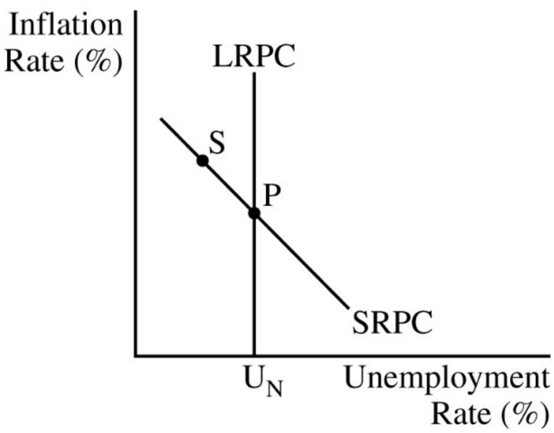


B (i) Point 3

State that real output will increase and explain that the new residential construction projects increase investment spending, which increases aggregate demand. **1 point**

(ii) Point 4

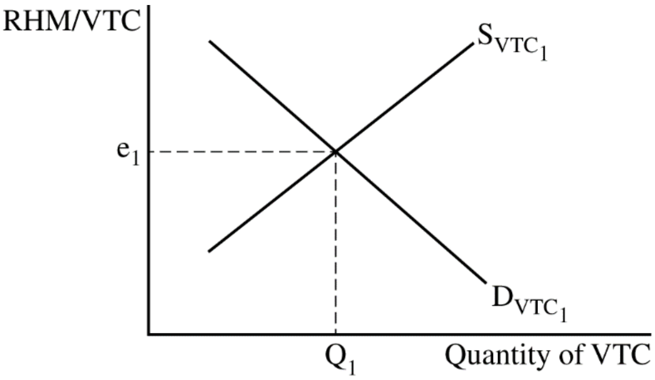
On the graph from part A, show a point labeled S on the SRPC to the left of point P. **1 point**



C

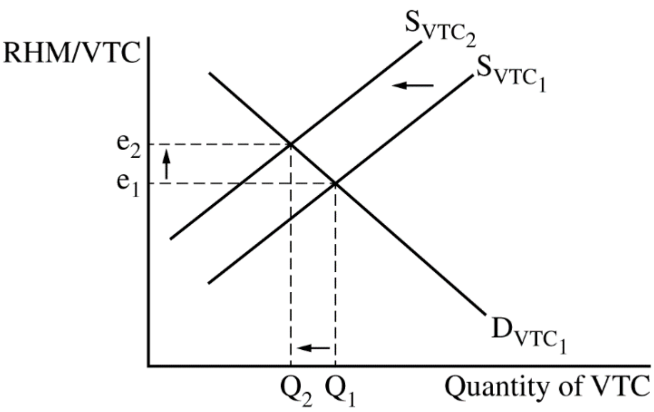
Point 5

Draw a correctly labeled graph of the foreign exchange market for the Vortanian crown. **1 point**



Point 6

The graph must show a leftward shift in the supply curve of the Vortanian crown, resulting in an appreciation of the Vortanian crown. **1 point**



D

Point 7

State that Vortania's net exports will decrease. **1 point**

E (i)

Point 8

State that the capital and financial account (CFA) balance in Vortania will move into surplus and explain that the current account (CA) moved into deficit and the balance of payments must balance (CA+CFA=0). **1 point**

(ii)

Point 9

State that employment in Vortania will decrease. **1 point**

F

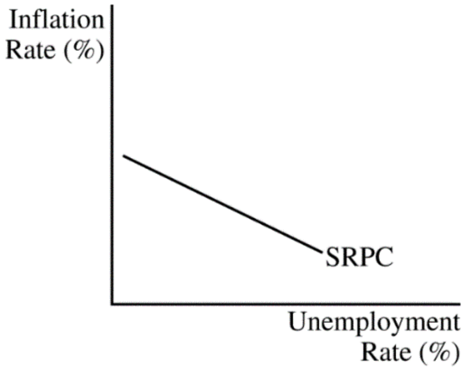
Point 10

State that the central bank of Vortania would sell Vortanian crowns in the foreign exchange market and explain that the increased supply of the Vortanian crown will cause it to depreciate. **1 point**

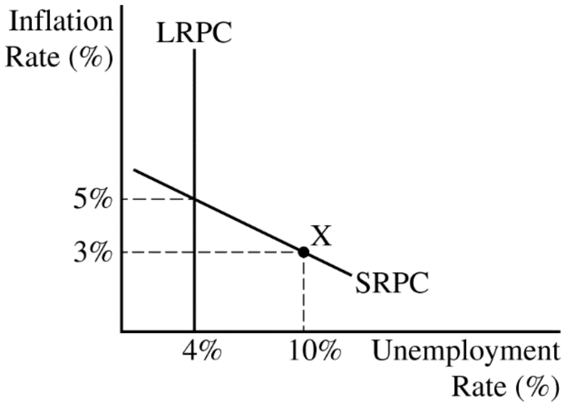
Question 1: Long — 10 points

A
Point 1
State that the actual unemployment rate is 10%. **1 point**

B
Point 2
Draw a correctly labeled graph of the short-run Phillips curve (SRPC). **1 point**



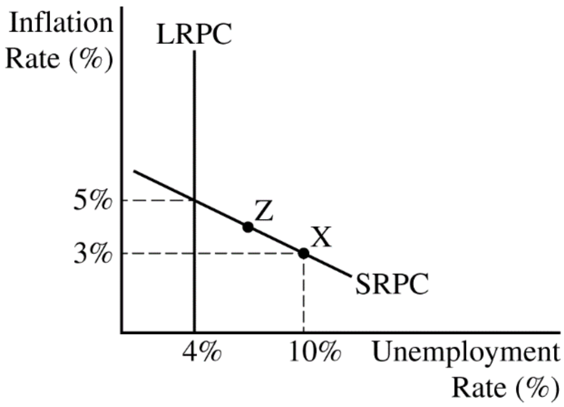
Point 3
The graph must include a vertical long-run Phillips curve (LRPC) at the natural rate of unemployment (4%), the expected inflation rate (5%) at the intersection of the SRPC and the LRPC, and a point labeled X on the SRPC to the right of the LRPC at the actual unemployment rate (10%) and the actual inflation rate (3%). **1 point**



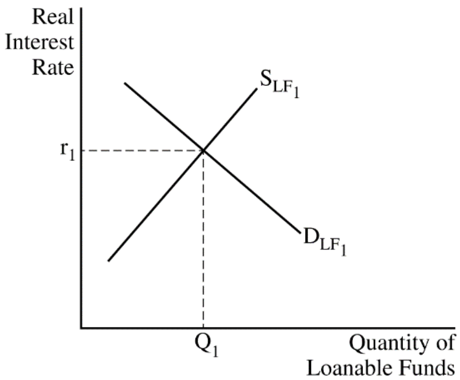
C
Point 4
State an increase in government spending, a decrease in taxes, or an increase in transfer payments. **1 point**

D **(i)** Point 5 — State that the government budget will move into deficit and explain that government outlays exceed revenue. **1 point**

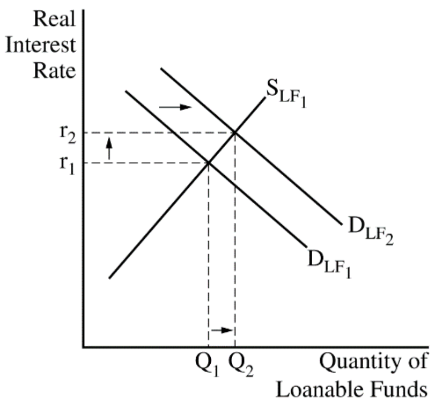
(ii) Point 6 — On the graph from part B, show a point labeled Z on the SRPC to the left of point X. **1 point**



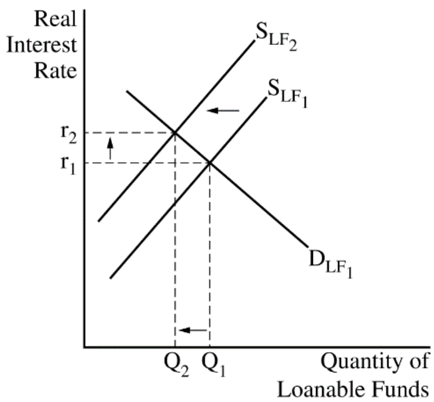
(iii) Point 7 — Draw a correctly labeled graph of the loanable funds market. **1 point**



Point 8 — The graph must show an increase in the demand for loanable funds (or a decrease in the supply of loanable funds), resulting in an increase in the equilibrium real interest rate. **1 point**



OR



E Point 9 — State that Barrikos’ capital and financial account (CFA) will move into surplus and explain that international investors will seek higher returns on financial capital in Barrikos, which will increase financial capital inflows into Barrikos. **1 point**

F Point 10 — State that Barrikos’ currency will appreciate and explain that demand for the currency will increase (or the supply of the currency will decrease). **1 point**

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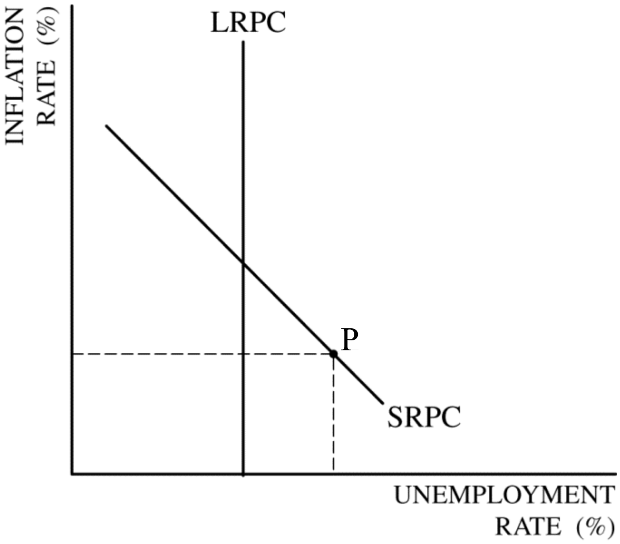
2016 SCORING GUIDELINES

Question 1

10 points (2+1+1+2+1+1+2}



(a) 2 points:

- One point is earned for drawing a correctly labeled graph showing a vertical LRPC and a downward sloping SRPC.
- One point is earned for showing point P on the SRPC to the right of LRPC.

(b) 1 point:

- One point is earned for stating that SRPC will shift to the left, and for explaining that producing at a level of output below full employment will create higher unemployment and lower inflationary expectations that will result in lower nominal wages and input costs.

(c) 1 point:

- One point is earned for stating that the Federal Reserve should buy bonds.

(d) 2 points:

- One point is earned for stating that the federal funds rate will decrease and for explaining that the money supply will increase, which will increase reserves and decrease the federal funds rate.
- One point is earned for stating that the real interest rate will decrease in the short run.

2016 SCORING GUIDELINES

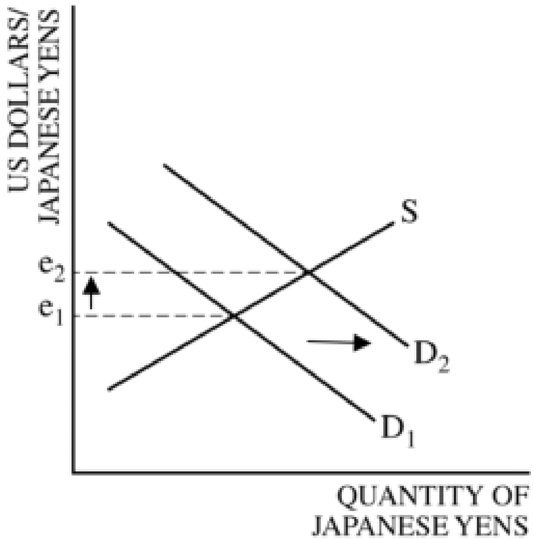
Question 1 (continued)

(e) 1 point:

- One point is earned for stating that real GDP will increase in the short run and for explaining that a decrease in the real interest rate will increase interest-sensitive spending, which includes consumption and investment in plant and equipment, resulting in an increase in aggregate demand.

(f) 1 point:

- One point is earned for stating that the demand for the Japanese yen will increase in the foreign exchange market.



(g) 2 points:

- One point is earned for drawing a correctly labeled graph of the foreign exchange market for the Japanese yen.
- One point is earned for showing a rightward shift of the demand curve for the yen and showing an increase in the dollar price of the yen (appreciating yen).

2016 SCORING GUIDELINES

Question 2

6 points (1+1+2+1+1)

(a) 1 point:

- One point is earned for stating that new loans are zero because the bank has no excess reserves (or because the bank is already fully loaned up).

(b) 1 point:

- One point is earned for correctly calculating the maximum amount of new loans that First Superior Bank can make as \$90 (= \$100 x (1 – 0.10)).

(c) 2 points:

- One point is earned for correctly calculating the maximum change over time in loans in the banking system as \$900 (= \$90 × 10).
- One point is earned for correctly calculating the maximum change over time in demand deposits in the banking system as \$1,000 (= \$100 × 10).

(d) 1 point:

- One point is earned for correctly calculating the maximum change over time in the money supply in the banking system as \$900 (= \$90 × 10).

(e) 1 point:

- One point is earned for stating that the money supply can be smaller than the maximum change identified when the public holds more money and /or banks hold more excess reserves.

2016 SCORING GUIDELINES

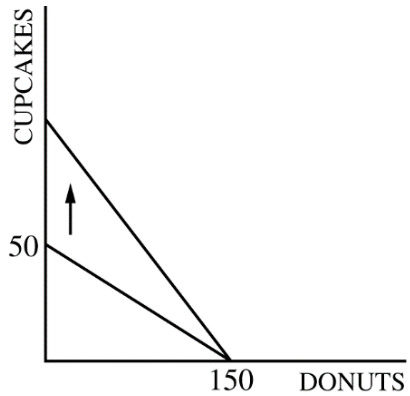
Question 3

5 points (1+1+2+1)

(a) 1 point:
- One point is earned for stating that John has the absolute advantage in producing donuts and for explaining that John can produce more donuts than Erica in one day (200>150).

(b) 1 point:
- One point is earned for stating that Erica has a comparative advantage in producing donuts and for explaining that Erica's opportunity cost of producing one donut (1/3 of a cupcake) is less than John's opportunity cost of producing one donut (1/2 of a cupcake).

(c) 2 points:
- One point is earned for indicating that John will benefit from specialization and trade.
- One point is earned for indicating that Erica will not benefit from specialization and trade.



(d) 1 point:
- One point is earned for drawing a correctly labeled graph of Erica's production possibilities curve, before the technology change, and for rotating the production possibilities curve outward showing greater production of cupcakes after the technology change.