

## 2015 AP<sup>®</sup> MACROECONOMICS FREE-RESPONSE QUESTIONS

2. Country X and Country Y are trading partners, and both produce furnaces and solar panels. The countries can produce the following amounts using equal amounts of resources.

Country X: 6 furnaces or 8 solar panels

Country Y: 6 furnaces or 12 solar panels

- (a) Which country has an absolute advantage in producing solar panels?
  - (b) Calculate the opportunity cost of a furnace in Country Y.
  - (c) Which country has the comparative advantage in producing furnaces? Explain.
  - (d) If the terms of trade were that 2 furnaces are exchanged for 1 solar panel, should Country X produce solar panels domestically or import solar panels from Country Y?
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3. Exchange rates and interest rates are important for macroeconomic decision making.

- (a) How does an increase in Japan's government budget deficit affect each of the following?
  - (i) The real interest rate in the short run in Japan. Explain.
  - (ii) Private domestic investment in plant and equipment in Japan
- (b) Draw a correctly labeled graph of the foreign exchange market for the euro, and show the effect of the change in the real interest rate in Japan from part (a)(i) on each of the following.
  - (i) Supply of euros. Explain.
  - (ii) Yen price of the euro
- (c) To reverse the change in the yen price of the euro identified in part (b)(ii), should the European Central Bank buy or sell euros in the foreign exchange market?

**STOP**

**END OF EXAM**

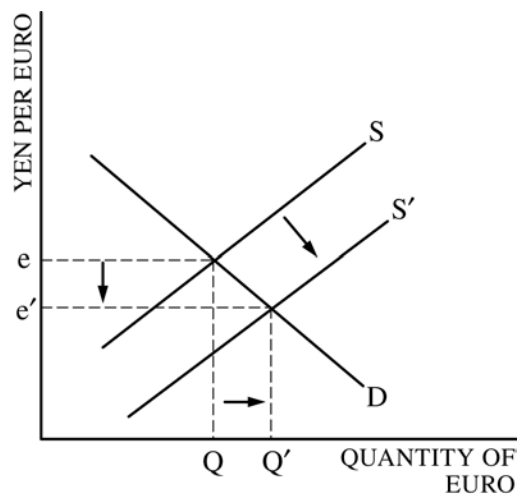
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**Question 3**

**6 points** (2+3+1)

(a) 2 points:

- One point is earned for stating that the real interest rate in Japan will increase in the short run because the supply of loanable funds will decrease or the demand for loanable funds will increase.
- One point is earned for stating that private domestic investment in plant and equipment in Japan will decrease.



(b) 3 points:

- One point is earned for drawing a correctly labeled graph of the foreign exchange market for the euro.
- One point is earned for showing that the supply curve for euros shifts to the right and for concluding that the yen price of the euro decreases.
- One point is earned for explaining that the European purchases of Japanese financial assets will increase due to the relatively higher rate of return in Japan.

(c) 1 point:

- One point is earned for stating that European Central Bank should buy euros.