

2007 AP[®] MACROECONOMICS FREE-RESPONSE QUESTIONS

2. In recent years, the Federal Reserve has made targeting the federal funds rate a main focus of its monetary policy.
- (a) Define the federal funds rate.
 - (b) If the Federal Reserve wants to lower the federal funds rate, what open-market operation would be appropriate?
 - (c) Assume that the open-market operation that you indicated in part (b) is equal to \$10 million. If the required reserve ratio is 0.2, calculate the maximum change in loans throughout the banking system.
 - (d) Indicate the effect of the open-market operation that you indicated in part (b) on the nominal interest rate.
 - (e) Assume that the Federal Reserve's action results in some inflation. What would be the impact of the open-market operation on the real rate of interest? Explain.
3. Indicate whether each of the following is counted in the United States gross domestic product for the year 2006. Explain each of your answers.
- (a) The value of a used textbook sold through an online auction in 2006
 - (b) Rent paid in 2006 by residents in an apartment building built in 2000
 - (c) Commissions earned in 2006 by a stockbroker
 - (d) The value of automobiles produced in 2006 entirely in South Korea by a firm fully owned by United States citizens

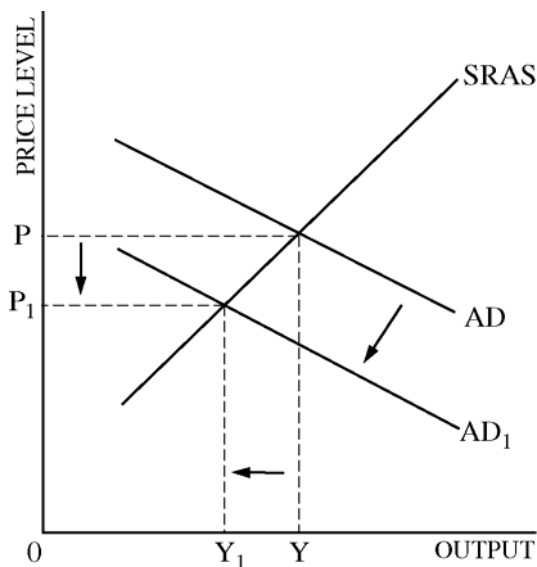
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END OF EXAM

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(c) 2 points:

- One point is earned for concluding that net exports will fall.
- One point is earned for stating that the appreciating dollar makes U.S. goods relatively more expensive to Japan, so U.S. exports to Japan would fall and imports rise.



(d) 3 points:

- One point is earned for a correctly labeled graph of AS/AD.
- One point is earned for showing a leftward shift of the AD curve.
- One point is earned for concluding that output and the price level both fall.

(e) 1 point:

- One point is earned for stating that unemployment rises because output is falling.

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Question 2

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

(a) 1 point:

- One point is earned for stating that the federal funds rate is the interest rate on short-term loans between banks.

(b) 1 point:

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

(c) 1 point:

- One point is earned for calculating the maximum change in loans, which is \$40 million.

(d) 1 point:

- One point is earned for stating that the nominal interest rate will fall.

(e) 2 points:

- One point is earned for stating that the real interest rate will fall.
- One point is earned for explaining that the real rate falls because the nominal rate has decreased and inflation has increased.