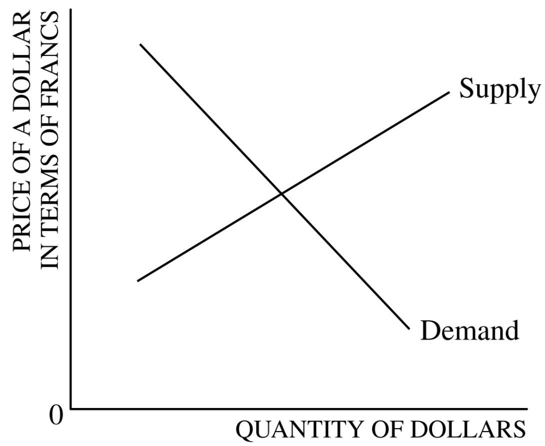
2. Assume that the United States and France are the only two countries in the world and that exchange rates between the two countries are flexible.



(a) Assume that there is an increase in the United States demand for French goods. Explain how this increase in demand will affect each of the following.

(i) The supply of dollars

(ii) The international value of the dollar

(b) Assume that there is an increase in real interest rates in the United States, but not in France. Explain how this increase in interest rates will affect each of the following.

(i) The international value of the dollar in the foreign exchange market

(ii) The quantity of dollars supplied in the foreign exchange market

3. Assume an economy with no international sector.

(a) Using a correctly labeled money-market graph, show how a decrease in the money supply will affect interest rates.

(b) Explain how the change in the interest rate you identified in part (a) will directly affect each of the three components of aggregate demand for this closed economy.

(c) Using a correctly labeled aggregate demand and aggregate supply graph, show how the change in the interest rate you identified in part (a) will affect each of the following in the short run.

(i) Output

(ii) Price level

END OF EXAMINATION

Part (d):

(1 point) Because net investment is a component of AD, increased investment will shift out the AD curve

[Insist on a reason for the AD curve's shifting out.]

(1 point) Increased net investment means an increase in the capital stock (or productivity or capacity) and an outward shift in AS.

Scoring Guideline for Macroeconomics Question 2

[2+2 = 4 Points]

Part (a)

(i) Supply of dollars **increases** **to buy** French Francs or **to buy** French goods **(1 point)**

(simply saying "increased supply of dollars" is not acceptable.)

(ii) **Depreciation** of U.S. dollar or reduced value of the dollar **(1 point)**

(using the explanation from part a (i)
(a wrong answer, but consistent with i), earns this point)

Part (b)

(i) Demand for U.S. dollar **increases** and the dollar **appreciates** **(1 point)**

(simply saying "appreciation of the dollar" is not acceptable)

ii) Quantity supplied of U.S. dollars **increases** **(1 point)**

(assertion OK)
(a wrong answer but consistent with (i), earns this point)

Scoring Guideline for Macroeconomics Question 3:

[2+3+2 = 7 Points]

Part (a)

Inward shift in the money supply and an increase in the interest rate

1 point Correct money supply graph with properly labeled axes

___labeled x-axis (Qm)
___labeled y-axis (i, p of money)
___Ms curve
___Md curve

1 point Inward shift in money supply and a higher interest rate

___Ms shift left
___interest rate increase

Alternative point allocation

1 point

- Flawed graph, showing increase in interest rate (Flawed = only one major error)
- Flawed graph, with correct written **explanation** (no assertions)

0 points

- Absence of graph (no need to read any accompanying text)
- Poor graph with assertion (Poor = 2 or more major errors)

Part (b)

1 point C: decrease linked graphically or with explanation (not assertion) to interest sensitivity

1 point I: decrease linked graphically or with explanation (not assertion) to interest sensitivity

1 point G: student expected to respond using automatic effects only—no discretionary interest- rate response is acceptable. (i.e., G decreases because cost of borrowing increases)

Two answers acceptable:

- no automatic response (must definitively say no change in G)
- G increases automatically because payments on debt increase

Part (c)

AD shifts in: Real income decreases and Price level falls

1 point Correctly labeled AD/AS graph with an inward shift in AD

___ x-axis (Y, GDP, Q)

___y-axis (P, PL, Prices)

___AS ___AD

___shift in AD

1 point Correct impact on Real Income (decrease) and Price Level (decrease) (1 point)

___ decrease in Y ___ decrease in P

Alternative point allocation

1 point

- Flawed graph, showing P and Y decrease (Flawed = only one major error)
- Flawed graph, with correct written **explanation** (no assertions)
- Shift in AS, as long as AD shifted down correctly

0 points

- Absence of graph (no need to read any accompanying text)
- Poor graph with assertion (Poor = 2 or more major errors)