

2. Assume the economy of Jenland is in short-run equilibrium at a real output level above full-employment real output.
- A. The banking system in Jenland has ample reserves. Identify a specific monetary policy action that the central bank of Jenland would implement to return the economy to full employment in the short run.
  - B. Draw a correctly labeled graph of the reserve market for Jenland, and show the effect of the central bank's action identified in part A on the policy rate.
  - C. Based on the change in the interest rate shown on your graph in part B, will each of the following increase, decrease, or remain the same in Jenland in the short run?
    - i. The price of previously issued bonds
    - ii. The price level. Explain.

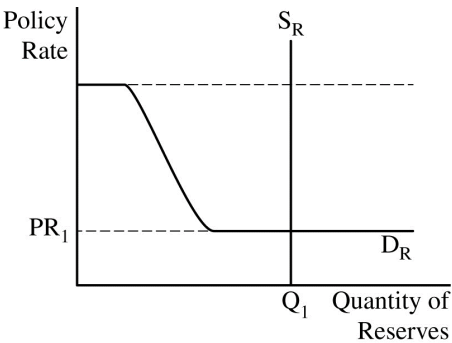
- 
3. Assume that Nepal is in long-run macroeconomic equilibrium and has an open economy.
- A. Draw a correctly labeled graph of the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for Nepal, and show each of the following.
    - i. The current equilibrium real output and price level, labeled  $Y_1$  and  $PL_1$ , respectively
    - ii. The full-employment output, labeled  $Y_F$
  - B. Nepal and Thailand are trading partners. Assume that Thailand experiences an increase in real income. On your graph in part A, show the short-run effect of the increase in real income in Thailand on real output and the price level in Nepal, labeling the new short-run equilibrium real output  $Y_2$  and the new short-run equilibrium price level  $PL_2$ .
  - C. Assume that at the short-run equilibrium shown on your graph in part B, Nepal is experiencing a 400 million rupee output gap. Policymakers in Nepal want to use discretionary fiscal policy to return the economy to full employment, and the marginal propensity to consume is 0.75. Calculate the minimum change and state the direction of change in government spending required to completely close the output gap in the short run. Show your work.
  - D. Assume instead that no discretionary policy actions are taken. Explain how automatic stabilizers in the short run would reduce the effect of the change in real output shown on your graph in part B.

**STOP**  
**END OF EXAM**

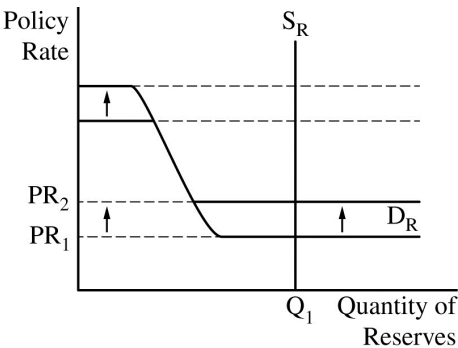
Question 2: Short

5 points

- |         |  |         |
|---------|--|---------|
| A       | State that the central bank would increase its administered interest rates or increase interest on reserves.                             | 1 point |
| Point 1 |  |         |
| B       | Draw a correctly labeled graph of the reserve market with the supply curve intersecting the demand curve in the range of ample reserves. | 1 point |
| Point 2 |  |         |

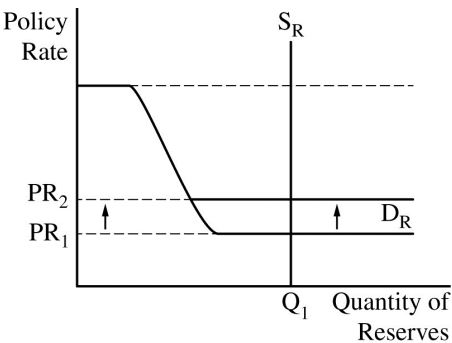


- |         |  |         |
|---------|--|---------|
| Point 3 | The graph must show an increase in the administered interest rates, resulting in an increase in the policy rate. | 1 point |
|---------|--|---------|



OR

The graph must show an increase in the lower bound of the demand curve for reserves, resulting in an increase in the policy rate.



---

|          |             |   |                |
|----------|-------------|---|----------------|
| <b>C</b> | <b>(i)</b>  | State that the price of previously issued bonds will decrease.  | <b>1 point</b> |
| Point 4  |             |   |                |
|          | <b>(ii)</b> | State that the price level will decrease and explain that the increase in interest rates will decrease interest-sensitive spending (consumption, investment, or net exports), which will decrease aggregate demand. | <b>1 point</b> |
| Point 5  |             |   |                |

---