

## 2006 AP<sup>®</sup> MACROECONOMICS FREE-RESPONSE QUESTIONS

2. Interest rates are important in explaining economic activity.
  - (a) Using a correctly labeled graph of the money market, show how an increase in the income level will affect the nominal interest rate in the short run.
  - (b) Using a correctly labeled graph of the loanable funds market, show how a decision by households to increase saving for retirement will affect the real market interest rate in the short run.
  - (c) Suppose that the nominal interest rate has been 6 percent with no expected inflation. If inflation is now expected to be 2 percent, determine the value of each of the following.
    - (i) The new nominal interest rate
    - (ii) The new real interest rate
3. The unemployment rate is an important indicator of the health of the United States economy.
  - (a) Assume that with the economy at full employment, the government implements an expansionary fiscal policy. How does the actual unemployment rate at the new short-run equilibrium compare with the natural rate of unemployment?
  - (b) Assume that a significant number of workers are involuntarily changed from full-time to part-time employment. Explain how this will affect the number of people who are officially classified as unemployed.
  - (c) Assume that the government reduces the level of unemployment compensation.
    - (i) Explain how this affects the natural rate of unemployment.
    - (ii) Using a correctly labeled graph, show how this affects the long-run Phillips curve.

**STOP**

**END OF EXAM**

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**Question 3**

**7 points** (1 + 2 + 4)

(a) 1 point:

- One point is earned for asserting that the actual rate will be lower than the natural rate of unemployment.

(b) 2 points:

- One point is earned for asserting that there will be no change in the number unemployed.
- One point is earned for explaining that part-time workers are considered employed.

(c) 4 points:

- One point is earned for asserting that the natural rate of unemployment will fall.
- One point is earned for explaining that people have more incentive to look for work as unemployment compensation diminishes.
- One point is earned for a correctly labeled graph.
- One point is earned for showing a leftward shift of the long-run Phillips curve.

