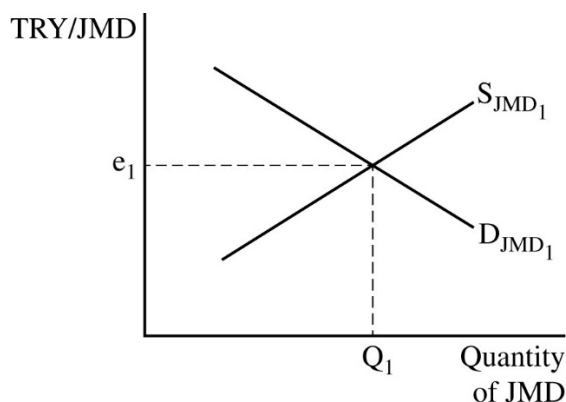


3. Assume that Jamaica has a cyclical unemployment rate of 4% and a balanced capital and financial account (CFA).
- (a) Identify a specific fiscal policy action that Jamaica's government would take to bring its economy to full employment.
- (b) Based solely on the short-run change in real output resulting from the fiscal policy action identified in part (a), what will happen to Jamaica's net exports? Explain.
- (c) Assume that Jamaica and Turkey are trading partners with flexible exchange rates. Jamaica's currency is the Jamaican dollar (JMD), and Turkey's currency is the lira (TRY). Draw a correctly labeled graph of the foreign exchange market for the Jamaican dollar relative to the lira, and show the effect of the change in net exports identified in part (b) on the supply of the Jamaican dollar and the international value of the Jamaican dollar.
- (d) How will the change in net exports identified in part (b) affect Jamaica's capital and financial account (CFA)? Explain.

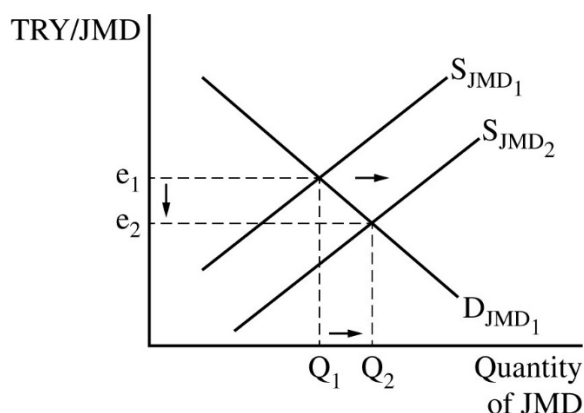
Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

Question 3: Short**5 points**

- (a) State an increase in government spending, a decrease in taxes, or an increase in transfer payments. **1 point**
- (b) State that Jamaica's net exports will decrease and explain that Jamaican demand for international goods will increase as a result of the increase in Jamaica's real income, which will increase Jamaican imports. **1 point**
- (c) Draw a correctly labeled graph of the foreign exchange market for the Jamaican dollar. **1 point**



For the second point, the graph must show an increase in the supply of the Jamaican dollar, resulting in a depreciation of the Jamaican dollar.

1 point**Total for part (c) 2 points**

- (d) State that Jamaica's capital and financial account (CFA) will move into surplus and explain that the current account (CA) moved into deficit and the balance of payments must balance ($CA + CFA = 0$). **1 point**

Total for question 3 5 points