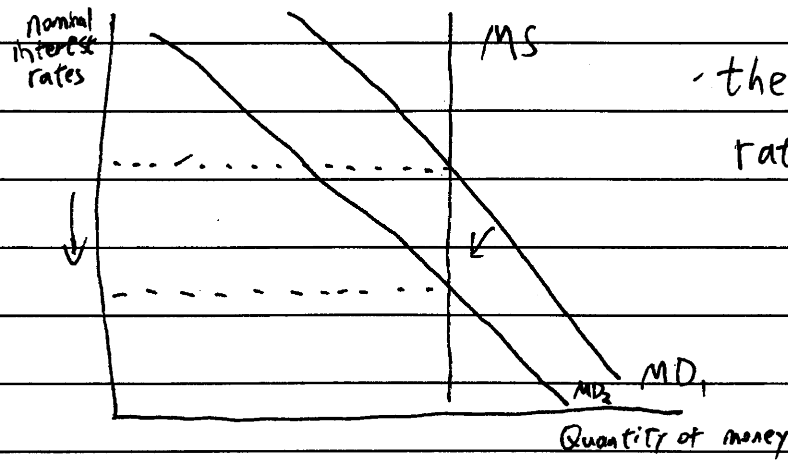
q2 macro 2010

Write in the box the number of the question you are answering on this page as it is designated in the exam.

2

2A

(a) 

- the nominal interest rate will decrease

(b) Due to the lower interest rate, ~~the~~ bond prices in the short run will increase, as demand for bonds increase.

(C) The lower interest rates will encourage consumption and investment, which increases aggregate demand. As a result, the increase in aggregate demand will establish a new short run equilibrium at a higher price level.

(d) ~~The Fed~~ To raise the interest rates back up to the level before the drop in credit card fees, the Federal Reserve can reduce the money supply by selling bonds. By releasing bonds and taking in money, the Federal Reserve shifts the Money Supply line to the left, raising the nominal interest rate once again.