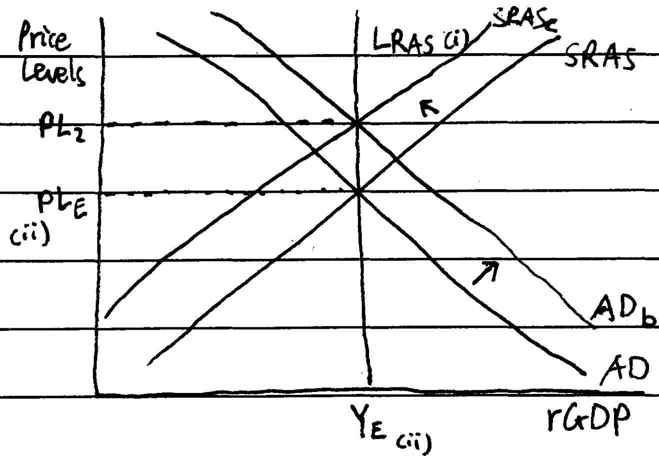
Write in the box the number of the question you are answering on this page as it is designated in the exam.

1

1A 1 of 2

(a)



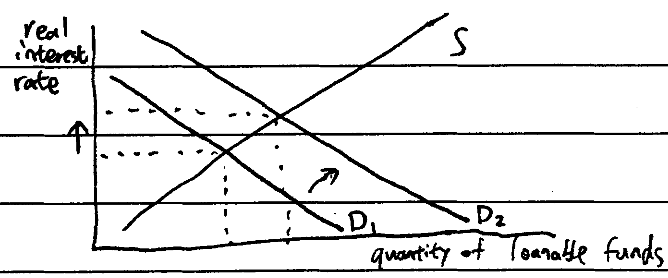
(b) (i) see graph, ADb

(ii) The increase on government spending increases aggregate demand, establishing a new short-run equilibrium at a higher output. The increased production increases the demand for workers, thereby decreasing the unemployment rate in the short-run.

(c) (i) The short-run aggregate supply curve in the new long-run equilibrium will be to the left of the initial long run equilibrium, as the increase in price levels caused by the increase in aggregate demand makes it more expensive for firms to hire workers, increasing the costs of production.

(ii) see graph, SRASc & PL2

(d)



• real interest rates increase

1

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

(e) (i) As real interest rates increase, investment decreases as it is more expensive to take out loans.

(ii) As real interest rates increase, firms are less willing to take out loans ~~to~~ and to invest in goods that will increase production because the opportunity costs of those loans have increased. Because of the reduced investment, the economic growth rate is sure to decrease as well, as firms are no longer expanding production as quickly.