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

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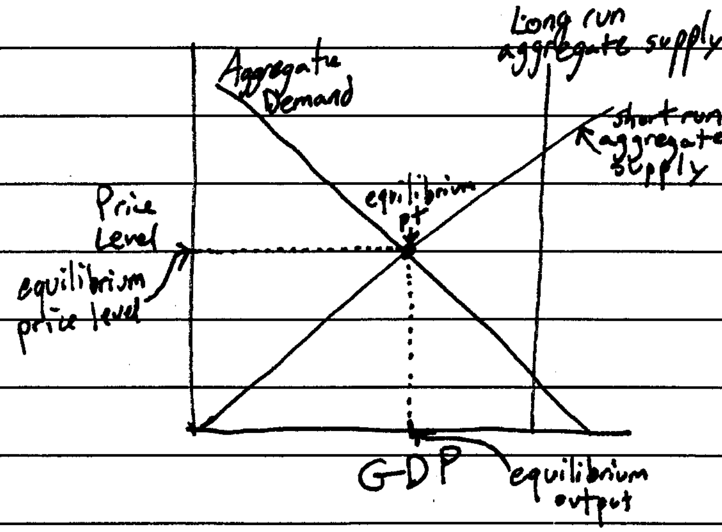
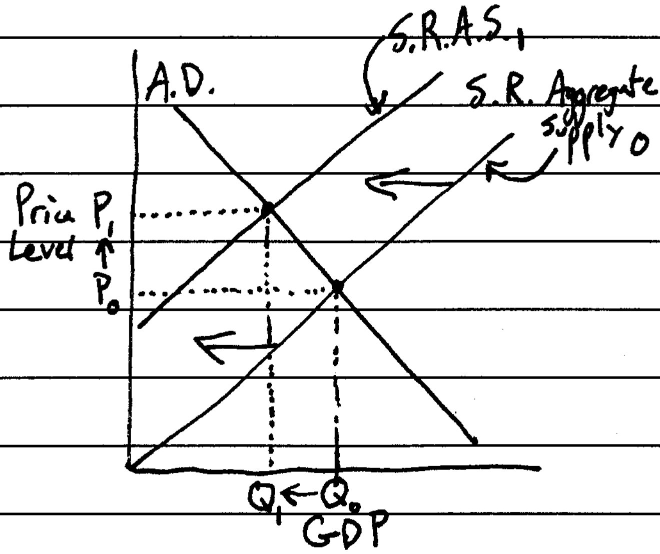
1A, 1

a) i), ii)



Current equilibrium output is lower than L.R.A.S. (which equals potential output) because the economy is below full employment. L.R.A.S. also equals the full employment level.

b)



Short run aggregate supply shifts to the left, b/c oil, a production input, increased in price. The resulting supply shock causes a decrease in output and an increase in price level. The new equilibrium price level (P_1) is higher than the original level (P_0), while the new output level (Q_1) is lower than the old level (Q_0)

c) Unemployment will increase in the short run, because the new equilibrium GDP is lower than the old equilibrium GDP. This drop in output results in an increase in joblessness in the short run, since wages are sticky and the self correcting mechanism will not alleviate the unemployment in the short run.

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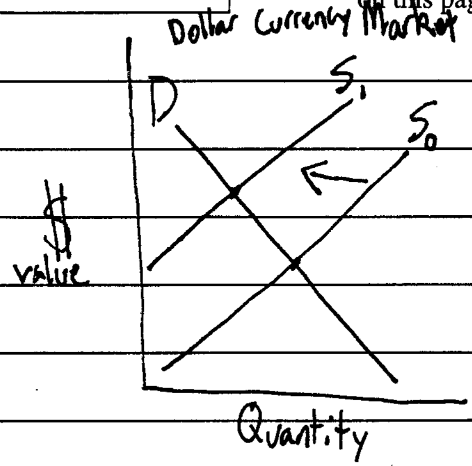
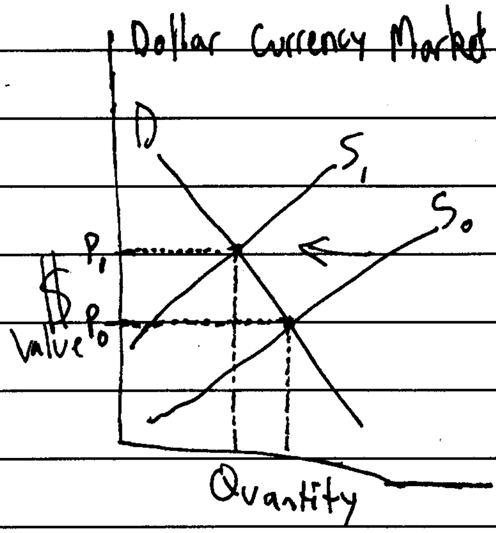
d)



Due to the drop in GDP in the U.S. economy, American consumers will demand less imports. As a result, they will supply fewer dollars in the foreign currency market. The inward shift of the $ supply curve results, moving S_0 to S_1, as shown

e)



~~Because the currency market supply curve of the dollar shifts inward, the market value of the dollar relative to the yen increases from P_0 to P_1. The dollar thus appreciates, due to the new equilibrium point in the $ currency market.~~