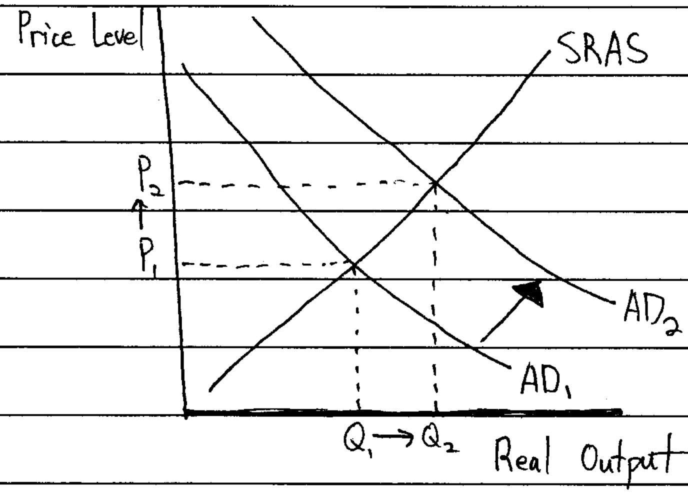
q1 macro 2008b

Write in the box the number of the question you are answering on this page as it is designated in the exam. 1

1A1

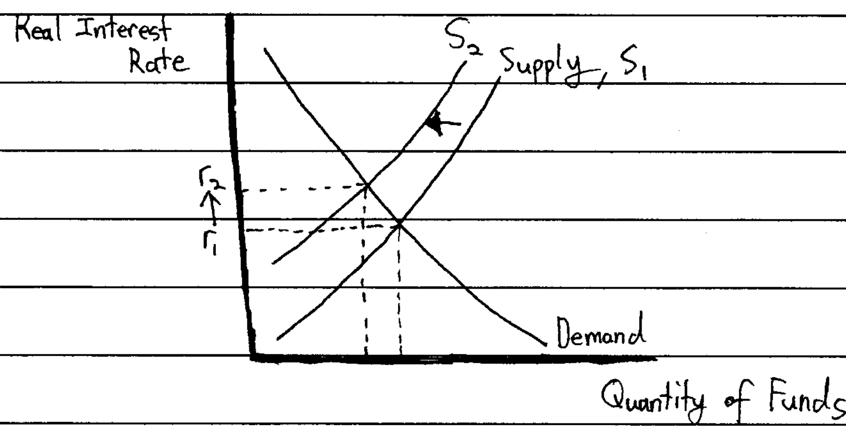
(a) The increase in government expenditures will increase aggregate demand. The short-run aggregate supply will be unaffected.

(b)



The increase in government expenditures shifts the aggregate demand curve to the right ($AD_1 \rightarrow AD_2$). The price level rises ($P_1 \rightarrow P_2$) and real output also increases ($Q_1 \rightarrow Q_2$).

(c)



When the government borows from the public, the supply of loanable funds decreases ($S_1 \rightarrow S_2$), which in turn increases the real interest rate. ($r_1 \rightarrow r_2$)

1

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

(d) When the real interest rate increases, the supply of Country Z's currency in the foreign exchange market will decrease. This is because people will reduce investments on foreign financial assets and increase investments on financial assets in Country Z. The decrease of the supply of Country Z's currency will cause Country Z's currency to appreciate.

(e) Due to the increase of the value of Country Z's currency, Country Z's exports will decrease. This is because Country Z's products will become relatively more expensive compared to the products of Country Z's trading partners.