IMACCLA, 1

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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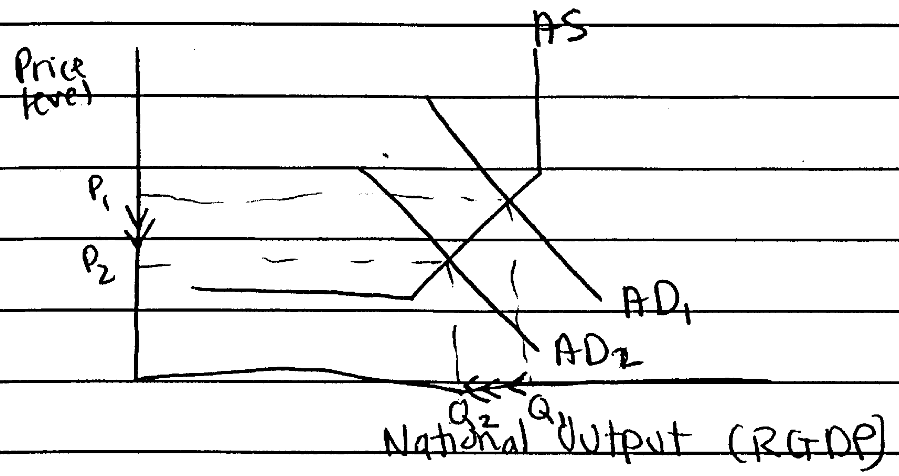
1 a)



i) output decreases as a result of the decrease in aggregate demand. Since aggregate demand is directly influenced by changes in consumer spending, government spending, private investment, and net exports, a sudden, large decrease in private investment will cause AD to ~~dec~~ fall.

ii) The price level falls as a result of the decrease in aggregate demand.

b) Employment decreases because of the decrease in output. Since the economy ~~it~~ is producing less, ~~les~~ fewer people will be hired.

c) An expancionary fiscal policy is needed to stimulate AD, in order to ~~offsett~~ offset the effects of the decrease in investment. An increase in government spending

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IMACCLA 2

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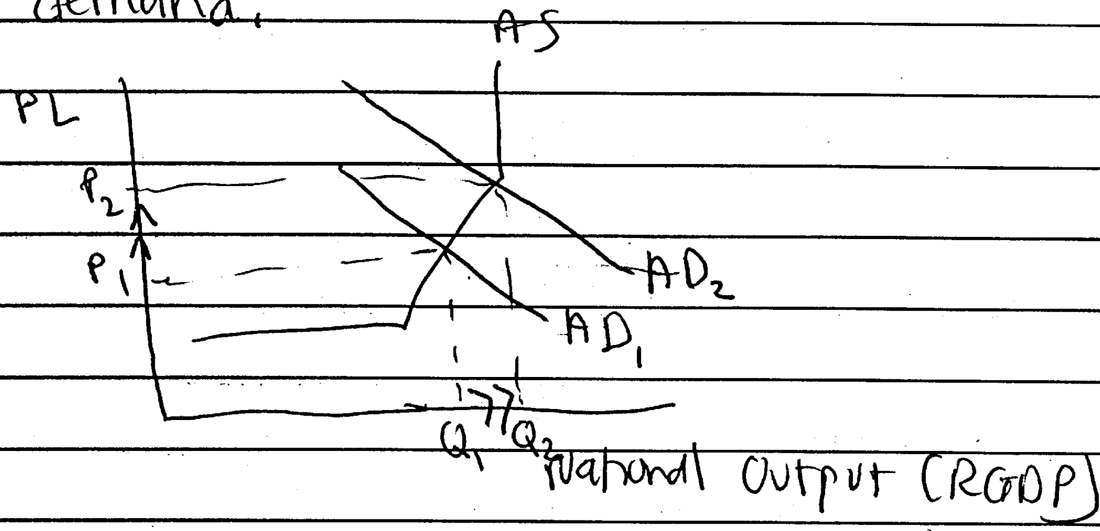
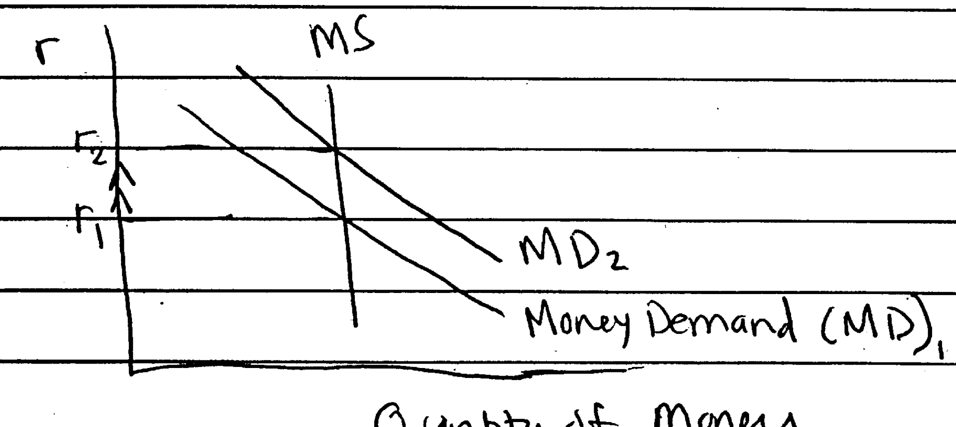
could accomplish this purpose.

i) Since aggregate demand is the sum of consumer spending, government spending, private investment, and ~~nex~~ net exports, increasing government spending would increase aggregate demand.



ii) As shown in the graph above, the increase in AD caused by more government spending would cause output and price level to rise.

iii)



The increase in government spending would

IMACCLA3

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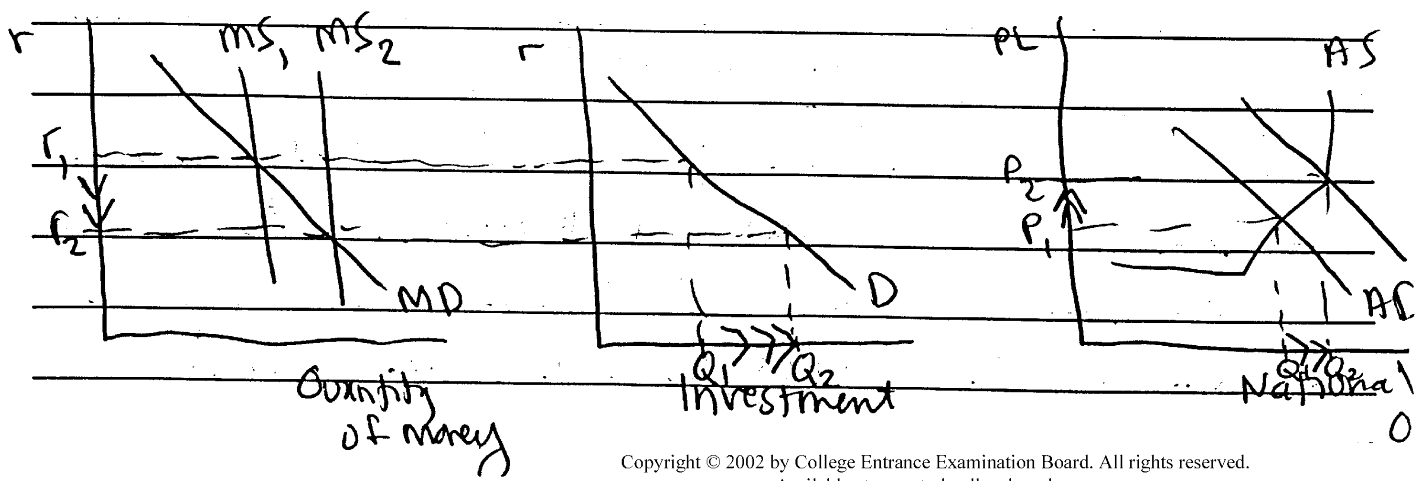
increase the demand for money, thereby increasin

d) To offset the effects of the decrease in investment, the central bank should practice an easy ~~money~~ monetary policy to ~~inc~~ encourage investment and stimulate AD. By buying bonds on the open market, the ~~CB~~ central bank can increase the money supply. The increase in the supply of money will cause interest rates to fall. Lower interest rates will encourage investment, thereby offsetting the effects of the decrease in investment by stimulating aggregate demand



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IMACCLA4

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i) Real interest Rates will decrease because of the expansion of the money supply.

ii) Lower real interest rates encourage investment, thereby increasing aggregate demand.

iii) The increase in AD causes an increase in output and the price level

e) i) Inflation will increase because the price level will continue to rise as long as AD keeps increasing. ~~Ab~~ Buying bonds on the open market increases the money supply, lowers the interest Rate, encourages investment, and stimulates AD

ii) The value of the domestic currency in foreign ~~markes~~ markets will depreciate. Because of the lower interest rates, foreigners will have less of an incentive to deposit their money in this country. They will ~~be~~ therefore demand less of this country's currency. Also, ~~be~~ high inflation discourages ~~foreigns~~ foreignes from buying this country's exports since the relative prices of these goods would be much higher. This would further decrease the demand for

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this country's currency.