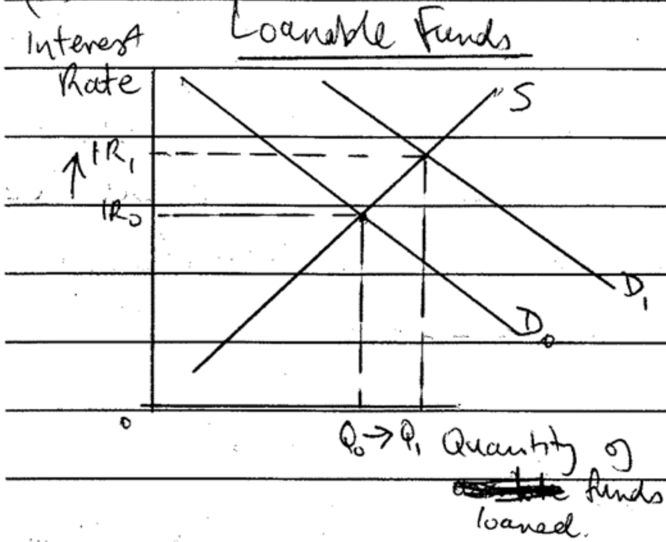
3

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

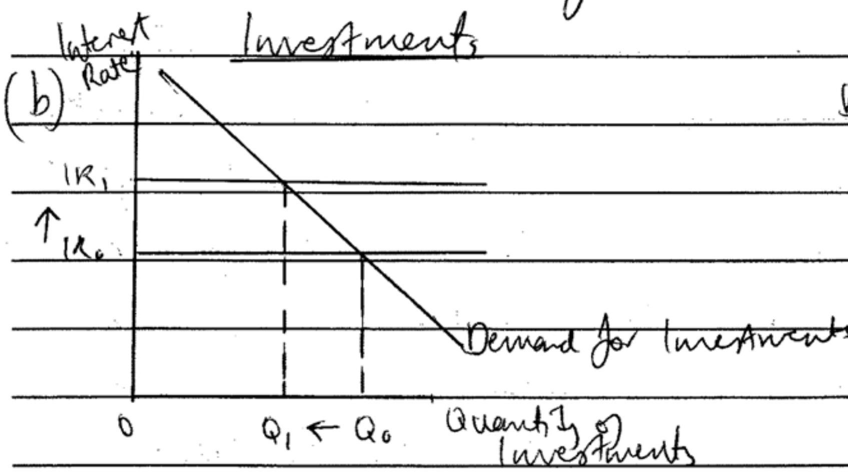
3A1

3 (a)



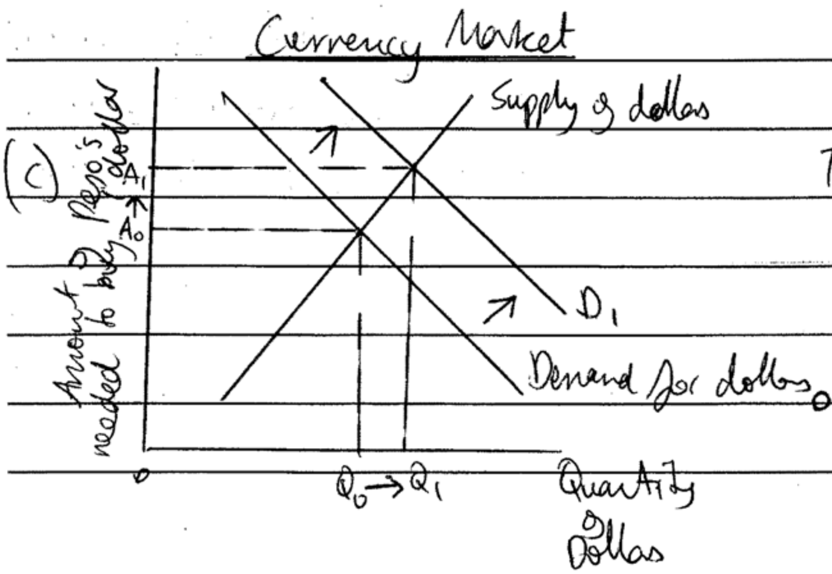
The increase in the demand for loanable funds (caused by the government borrowing money) causes the real interest rate to rise. The government needs to borrow money as it is already in a deficit, so it has no extra funds.

(b)



Due to the increase in interest rates, business investment will fall, shown on the horizontal axes on the graph for investments.

(c)



The increased ~~intest~~ interest rate in country A causes an increase in demand for its dollar.

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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3A2

This is because foreign investors want to store their money in a country where their money will earn high interest. The increase demand for country A's dollars leads to an appreciation of country A's dollar. This is exemplified on the vertical axis, the amount of Pesos needed to buy 1 of Country A's dollars.

(d) Country A's goods become less competitive as they are now more expensive in terms of country B's pesos. Country A will therefore import more of country B's goods, and export less of its goods to country B.