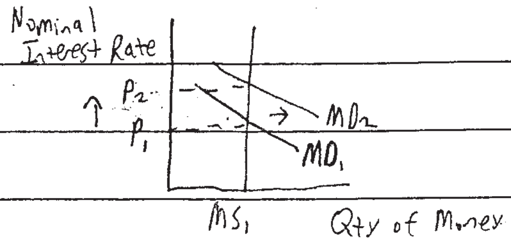
Write in the box the number of the question you are answering on this page as it is designated in the exam.

1

1A, 1

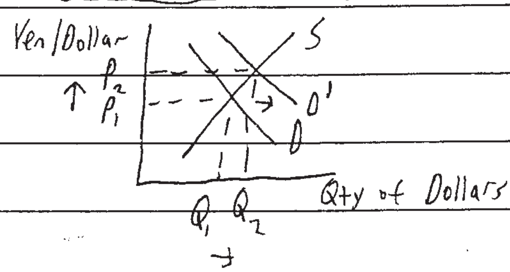
a) Money Market



(i) MD = Demand for money goes up (shifts to the right)

(ii) Nominal interest rate goes up from P_1 to P_2 (gets higher)

b) Foreign Exchange Market



(i) Demand for the dollar increases (shifts to the right)

(ii) Price of the dollar increases (goes up from P_1 to P_2)

c) The higher price of the dollar will make US goods more expensive relative to foreign goods. Thus, imports will rise and exports will fall (other countries will now have to pay more for US goods and will ~~export~~ import less of them, causing this fall in exports for the US). From the US perspective, foreign goods will now be cheaper to import with the dollar's increase in value, thus the increase in imports. Overall, net exports will fall ~~and the US will experience a deficit~~ because X − I will be overtaken by a rush of Imports and a Fall of Exports. ~~The net exports will become negative~~

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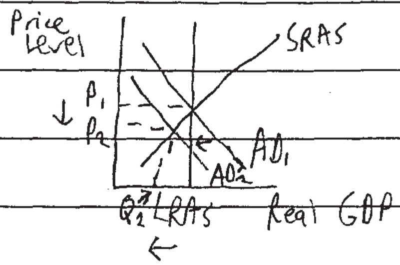
d) AD/AS



(i) Aggregate demand will shift to the left because of the lower Net exports value/balance

(ii) Output will fall and price level will fall

e) Unemployment will rise in the short run because the smaller output (real GDP) produced after the fall in AD will induce companies to lay off employees not needed to ~~###~~ maintain the new lower short run production level in the economy.