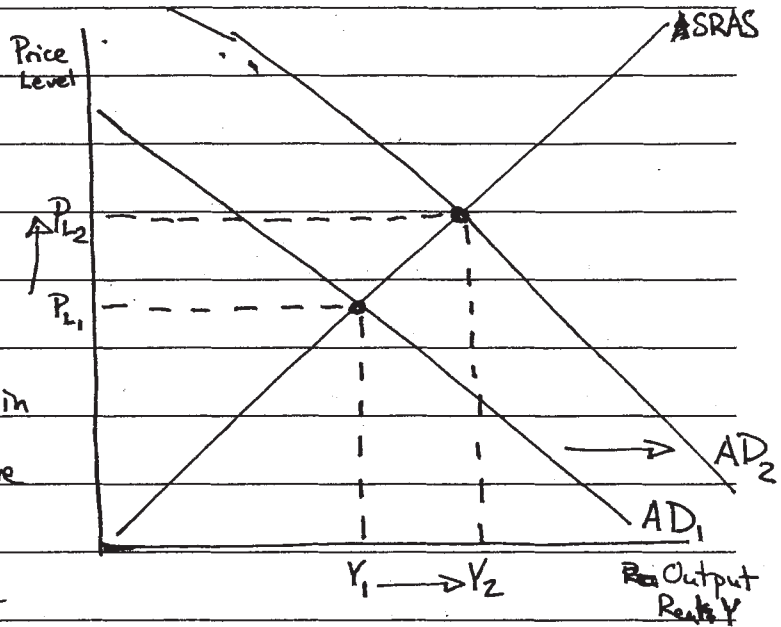


Question 1

a.)

i) Aggregate Demand in New Zealand will increase. Australia recovering from its recession will result in Australians demanding more goods both at home and abroad, which will result

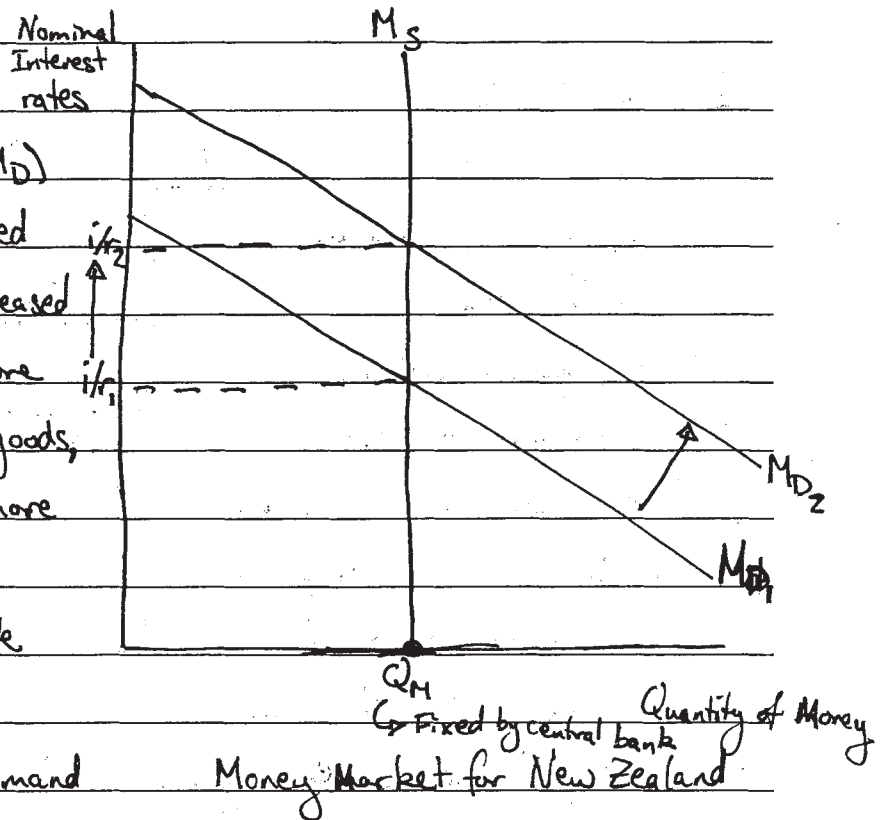


in New Zealand's net exports (NX) increasing. Since ~~the~~ net exports are a component of aggregate demand, aggregate demand in New Zealand will in turn increase.

ii) ~~the~~ Output in New Zealand will increase, due to an increased aggregate demand and an unchanged short-run aggregate supply.

b)

i) Demand for Money (M_D) will increase. Increased Aggregate Demand and increased Output will result in more people wanting to buy goods, which they will require more money to do.



ii) The nominal interest rate will increase, due to an increased demand for money and a fixed supply of money.

c) Depending on how much the price level increases relative to rising nominal interest rates, real interest rates may rise, fall or remain unchanged. According to the Fisher effect real interest rates equal nominal interest rates minus inflation. If inflation, also known as the increase in the price level, is greater than the rise in the nominal interest rate, the real interest rate will actually fall. Conversely, if nominal interest rate rises are greater than inflation, then real interest rates rise. If nominal interest rate rises equal inflation, then the real interest rate is unchanged.

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

1

1A3

d)

i) In the long run,

~~short run~~ short run aggregate

supply will increase as shown.

Unemployment ~~and~~ will enable

firms to drive wages,

a cost of production, down,

which will result in $\$$

Short run supply increasing.

~~This is~~ This is a classical or self-correcting

view of how the market will be corrected.

ii) Aggregate Demand will remain unchanged,

but the quantity of goods demanded

will increase with the falling price level, due to the wealth, and net export ~~and~~ effects. effects

