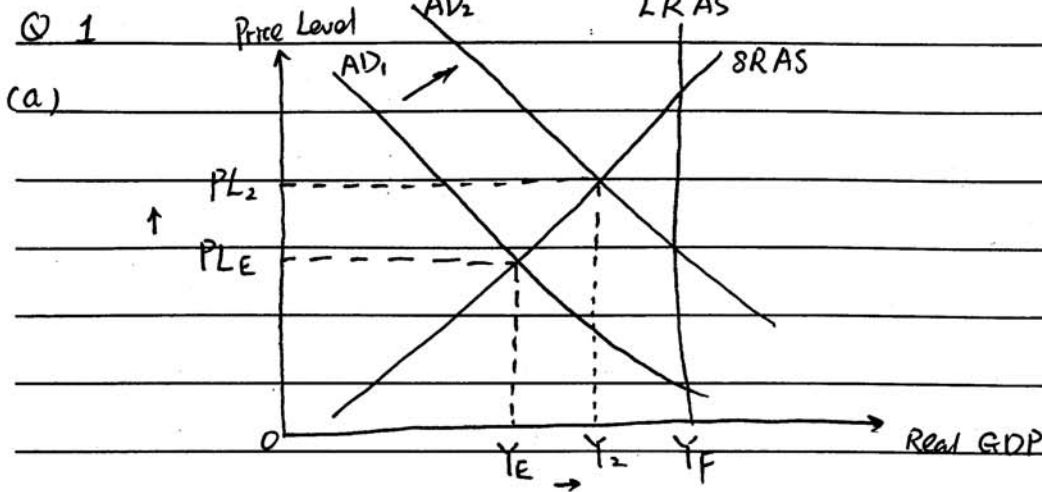


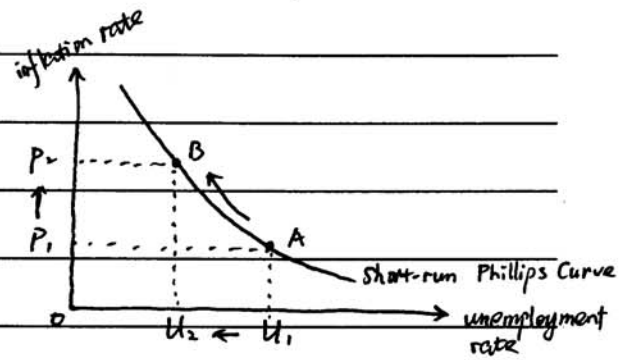
Write in the box the number of the question you are answering on this page as it is designated in the exam.

1 (a), (b), (c), (d)



- (b) (i) As shown, Aggregate Demand increases from AD_1 to AD_2 .
- (ii) As shown, both equilibrium price level and real output increase.

- (c) Increased military spending causes a movement from point A to B along the short-run Phillips Curve. Unemployment rate falls from u_1 to u_2 and inflation rate increases from P_1 to P_2 .

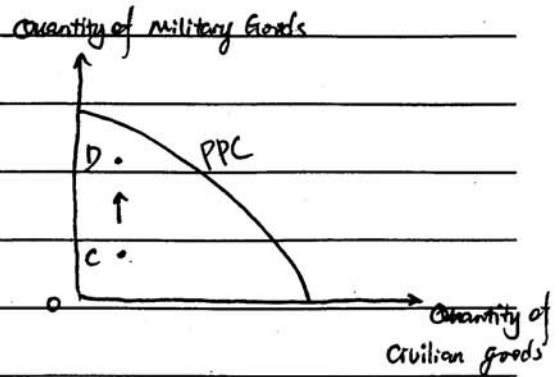


- (d) The real interest rate will increase. Since the increased military spending is financed through government borrowing, the demand for loanable funds in the loanable funds market increases. Hence, the demand curve for loanable funds shift to the right and the real interest rate rises correspondingly.

1 (e)

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

1 (e) Since the question specifies that the economy is producing at an output less than the full-employment output level, the economy is initially at point C, inside the PPC curve.



Since not all resources have been efficiently employed in the production, the economy can thus increase the quantity of military goods without trade-off of civilian goods. Hence, the increased military expenditure is shown by upward movement from C to D.