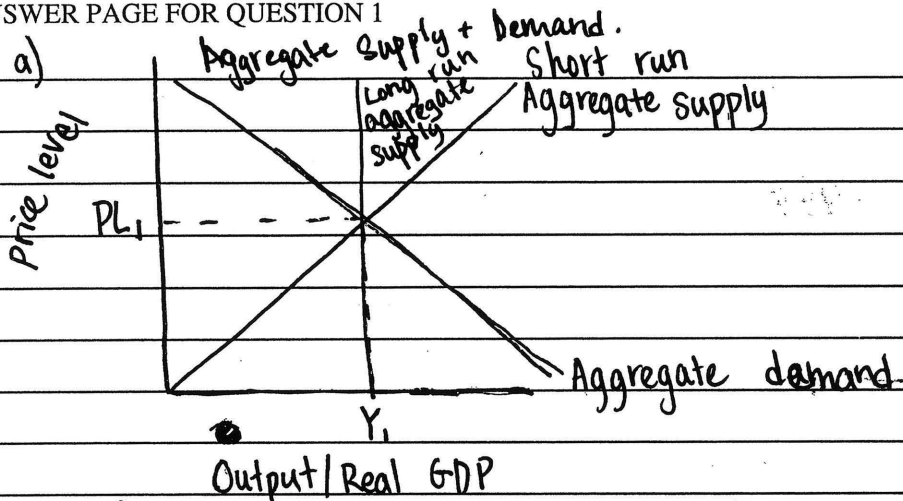


ANSWER PAGE FOR QUESTION 1

1 A.

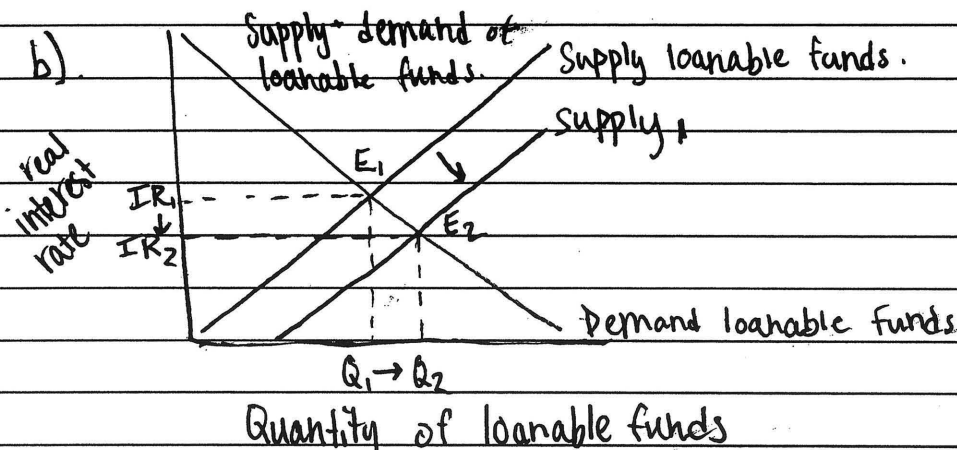
① a)



i) The price level is the value on the y-axis marked PL_1 , which is the value of the price at the point of intersection between aggregate demand and long run aggregate supply.

ii) The output level is the value on the x-axis marked Y_1 , which is the value ~~at the~~ of output at the point of intersection between aggregate demand and long run aggregate supply.

b)



If personal savings increase, people will put their money in banks. Banks will have more money to lend, so the supply of loanable funds will shift to the right. At the new equilibrium, marked E_2 , there will be a greater quantity of loanable funds and a lower interest rate.

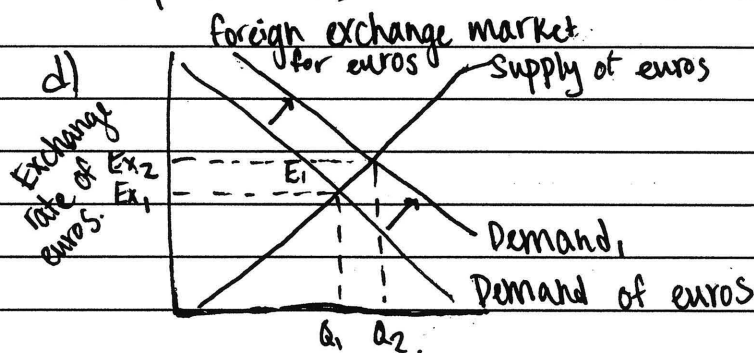


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ADDITIONAL PAGE FOR ANSWERING QUESTION 1

c) i) As indicated on the graph in part b, interest rates will decrease when personal savings increase. Interest-sensitive expenditures will increase because ~~the~~ households and firms can borrow money at a lower interest rate. It will be 'cheaper' to borrow money. This increase can be seen on the graph in part b, where at E_2 , ~~the~~ the equilibrium quantity is higher than it was before.

ii) The rate of economic growth will increase because investment fuels growth. Firms will be able to purchase capital equipment, which will mean workers will be more productive, which will increase the growth rate.



Quantity of euros

i) The demand for the euro will shift to the right because people will want to invest their money in Europe, because they will get a higher rate of return on their investments. People will demand more euros so they can invest in ~~the~~ European assets.

ii) The value of the euro relative to the dollar will rise, which means that the euro will appreciate compared to the dollar. As demand is shifted to the right, the new equilibrium has a higher exchange rate. When people exchange their euros for dollars, they are also increasing the supply

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ADDITIONAL PAGE FOR ANSWERING QUESTION 1

of dollars, which will lower the exchange rate for dollars.

e) When the value of the euro appreciates compared to the dollar, the United States current account will change to a surplus. American goods will seem cheaper to Europeans, so they will buy more goods, which means that American exports will rise. We will import fewer European goods because they will seem more expensive. Therefore, the current accounts will run a surplus.

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