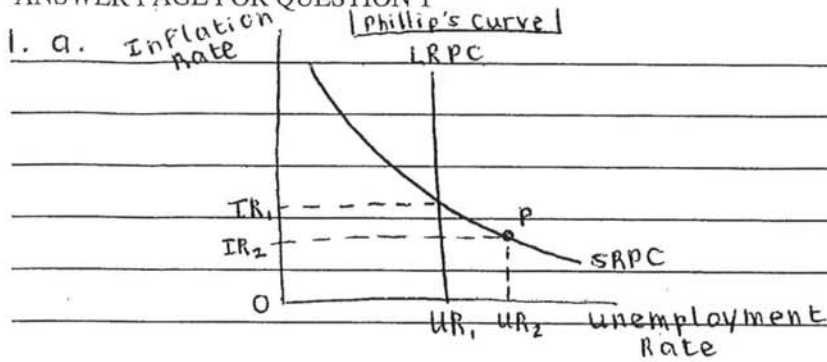
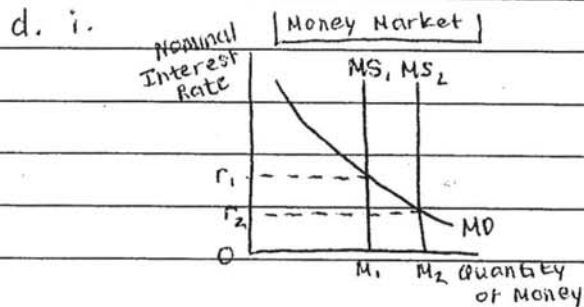


ANSWER PAGE FOR QUESTION 1



b. IF no policy actions are taken to combat the recessionary gap, in the long run the short run phillips curve will shift downward (left). This is because as wages go from sticky to flexible, they will adjust to the lower price level. This decreases the cost of inputs and due to a lower expected inflation, SRAS will shift right and SRPC will shift left.

c. To lower unemployment, the Fed should conduct an expansionary monetary policy of buying bonds.



Buying bonds will \uparrow the MS from MS₁ to MS₂ \Rightarrow \downarrow in the nominal interest rate from r₁ to r₂ \Rightarrow \downarrow in the Fed Funds Rate due to downward pressure on rates

ii. The real interest rate will decrease in the short run because real interest rate = nominal interest rate - inflation rate and if the nominal rate \downarrow while inflation \uparrow then the real interest rate must decrease.

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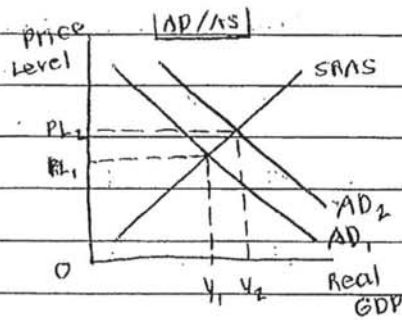
q1 macro 2016 continued

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1A

ADDITIONAL PAGE FOR ANSWERING QUESTION 1

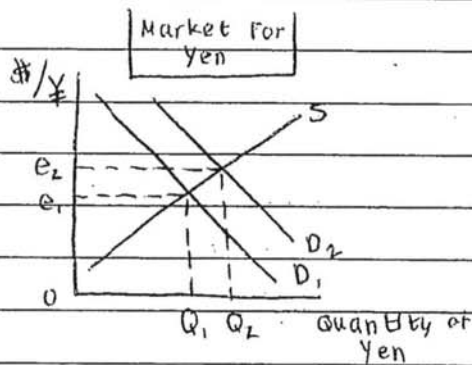
e.



~~the~~ The \downarrow in the real interest rate \Rightarrow \uparrow in interest-sensitive investment and consumption \Rightarrow \uparrow in AD from AD_1 to AD_2 \Rightarrow \uparrow in real GDP from Y_1 to Y_2

f. Due to the \uparrow in real GDP in the US \Rightarrow US citizens will have a greater income and therefore import more from other countries \Rightarrow \uparrow in the demand for Japanese Yen.

g.



The \uparrow in the demand for Japanese Yen \Rightarrow an appreciation of the yen from e_1 to e_2

GO ON TO THE NEXT PAGE.