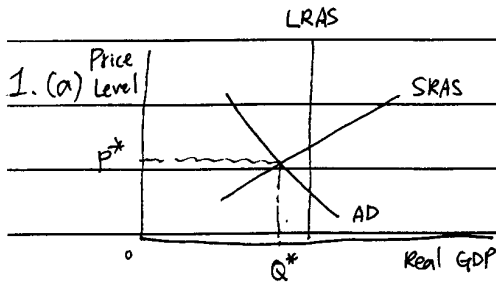


Write in the box the number of the question you are answering on this page as it is designated in the examination.

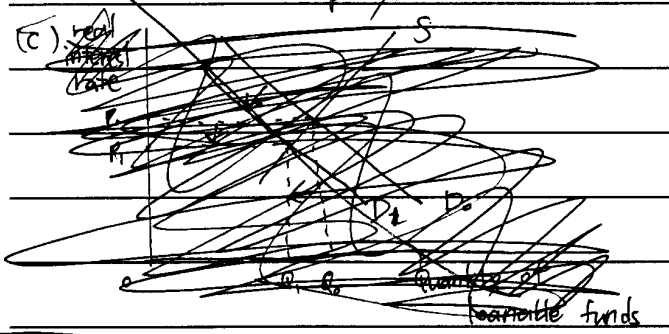
1.

1A1



Long run AS curve is vertical line, meaning full employment. Current output is  $Q^*$ , where short run AS curve intersects with AD curve.

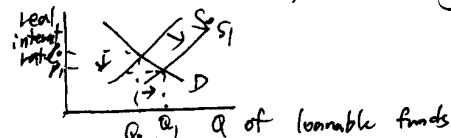
(b) According to classical economists, even if no policy action is taken, prices and wages eventually falls, resulting in reduced input costs. Thus, ~~Aggregate Supply~~ short-run aggregate supply curve shifts to the right, <sup>(SRAS increases)</sup> resulting in decrease in price level and increase in real GDP. Because real GDP rises, ~~employment~~ employment also increases to the full employment.



If government imposes tax, individuals reduce consumption and save more because it is more expensive to buy the same product than before.

~~Thus, the aggregate demand, which consists of consumption, Government spending, Investment and Net export, reduces, resulting in leftward shift of AD curve. So real interest rate falls.~~

People save more, so loanable funds increases, resulting in decrease supply of  $\downarrow$  in real interest rate.



1.

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

1A<sub>2</sub>

(d) If real interest rate falls, individuals can easily lend money, so they invest more. Investment on capital, machines or resources causes aggregate supply to increase in the long run.