

MACROECONOMICS

Section II

Total Time—1 hour

Reading Period—10 minutes

Writing Period—50 minutes

Directions: You are advised to spend the first 10 minutes reading all of the questions and planning your answers. You will then have 50 minutes to answer all three of the following questions. You may begin writing your responses before the reading period is over. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. Use a pen with black or dark blue ink.

1. Assume the United States economy is in recession.
 - (i) Current price level, labeled PL_1
 - (ii) Current output, labeled Y_1
- (b) Now assume the euro zone, a major trading partner of the United States, enters into a recession.
 - (i) What will be the effect on United States exports to the euro zone? Explain.
 - (ii) On your graph in part (a), show the effect of the change identified in part (b)(i) on real output in the United States.
 - (iii) What will be the effect of the change identified in part (b)(ii) on unemployment in the United States?
- (c) Assume the euro zone recession causes a decrease in the demand for United States dollars in the foreign exchange market.
 - (i) Will the euro appreciate, depreciate, or remain unchanged against the dollar? Explain.
- (d) Assume the United States implements a combination of expansionary fiscal and monetary policies. In the absence of complete crowding out, what will be the effect of these policies on each of the following?
 - (i) Aggregate demand in the United States
 - (ii) The price level in the United States
 - (iii) Interest rates in the United States. Explain.