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. <u>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</u>. 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. <u>Use a pen with black or dark blue ink</u>.

1. Canada is an open economy that is currently in a recessionary output gap.

   (b) The central bank and the government do not take any policy actions to close the output gap.

      (i) Explain how the economy will adjust to full employment in the long run.

      (ii) On your graph in part (a), show how the economy adjusts to full employment in the long run.

   (c) Suppose the Canadian government is unwilling to wait for the long-run adjustment process. The marginal propensity to consume is 0.8. The equilibrium real output is \$500 billion and the full-employment output is \$540 billion.

      (i) Calculate the minimum change and indicate the direction of change in government spending required to shift the aggregate demand curve by the amount of the output gap.

      (ii) Calculate the minimum change and indicate the direction of change in taxes required to shift the aggregate demand curve by the amount of the output gap.