3. Assume that the economy of country Zen is in long-run macroeconomic equilibrium.

(b) On your graph in part (a), show the short-run effect of an increase in consumer confidence. Label the new equilibrium real output Y_2 and the new equilibrium price level PL_2.

(c) Assume that the banking system in Zen has ample reserves. Suppose that the central bank's goal is to maintain a stable price level at PL_1. Based on the change in the price level shown in part (b), identify one specific monetary policy action the central bank would take to achieve its goal.

(d) Based on the monetary policy action identified in part (c), will real output increase, decrease, or stay the same in the short run? Explain.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

STOP

END OF EXAM