AP® Macroeconomics
2003 Sample Student Responses
Form B
a) The current output is at $Q_0$ and price level is $P_0$.

b) When government increases spending to achieve full-employment output, one of the components of AD (c + I + G + (x-m)) will increase, causing aggregate demand to shift to the right (as labeled as AD1 in the above graph). As a result, $P_0$ has shifted to $P_1$, and $Q_0$ has shifted to $Q_1$. Both output and price level have increased.

c) Due to the increase in deficit spending, the demand for loanable funds also increases causing interest and quantity of loanable funds to increase.

d) Since the interest rate of this country has increased, many foreigners would be attracted to invest in this country. As a result, the demand of this currency increases, and the international value of this currency will also increase.
e) As the international value of this currency increases, this country's goods will be relatively more expensive to other countries' goods. Thus, this country's exports will decrease and imports will increase. This will create a trade deficit as imports are greater than exports.

f) Although originally the government deficit spending is to increase aggregate demand, according to the loanable-funds market discussed in part c, real interest rates will also increase. As a result, investment will decrease. In the long run, if net investment continually decreasing, then it means that the long-run growth will also decrease.
Write in the box the number of the question you are answering on this page as it is designated in the examination.

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\[ \text{Graph of } AS_t, AD_t, GDP, GDP_c, \text{ and } GDP_y. \]

(i) The aggregate demand will increase because government spending is demand-pull.

(ii) Output will increase because economy also has increased in labor.

(iii) Price level would increase because more people are employed, hence more money to spend.

The real interest rate will increase, because government needs to sell government bonds or borrow money from the citizens, in order to increase spending and decrease deficit. When government spends, money it increases the interest rate or crowding-out effect. Also, selling government bonds increases the interest rate also.

(iv) The international value of country’s currency will increase, because the interest rates are high, foreign investors would want to loan their money to banks and for that they need to change their currency to country’s currency. If there is a lot of demand for country’s (x) currency, then the price of their currency will increase or the value
c) Country (x) exports will decrease, because their currency value increased which makes the exports more expensive.

Imports would increase, because now the country (x) can buy more foreign goods with the same amount of money.

d) Imports will be greater than exports, country (x) will be in trade deficit.

The long-run growth of the country (x) can be seen from two sides:

- Side one: The country (x) government would increase taxes to even the deficit, which will slow down the economy, the GDP will decrease and unemployment will increase.

- Side two: The country (x) might attract foreign investors because of high interest, and foreign investors will invest in country (x), which results will be growth of the economy, increase in GDP, decrease in unemployment and increase in price level.