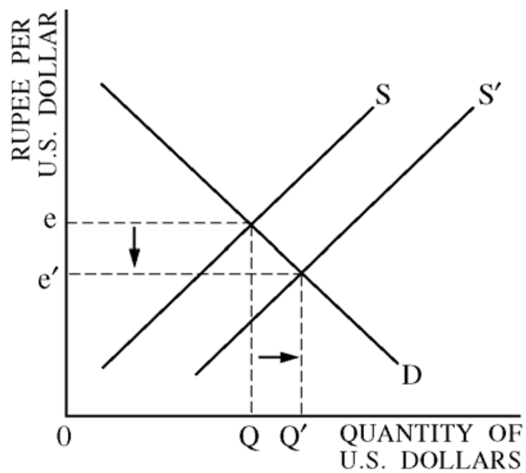
Question 2

6 points (2 + 2 + 2)

(a) 2 points:
- One point is earned for stating that the transaction will be recorded in the current account.
- One point is earned for stating that the transaction will be recorded in the current account.

(b) 2 points:
- One point is earned for stating that the current account balance will decrease or move toward a deficit.
- One point is earned for explaining that the increase in income causes imports to increase.



(c) 2 points:
- One point is earned for a correctly labeled graph of the foreign exchange market for the U.S. dollar.
- One point is earned for shifting the supply of U.S. dollars to the right and showing a depreciation of the dollar.

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2

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

2A1

a) i) current account

ii) current account

b) an increase in US real income would negatively affect the current account balance; an increase of real income would increase imports which would lesson net exports, a component of the current account

(the current account balance would decrease - decrease surplus / ~~if there was~~ or ~~or~~ ~~as~~ increase deficit ~~if there~~ depending on the balance prior to the increase in real income)

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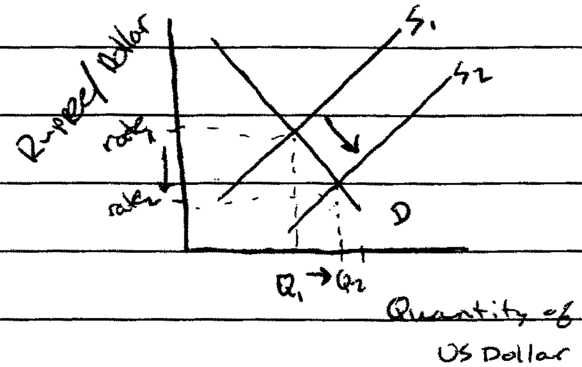
2

2A2

c)



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2

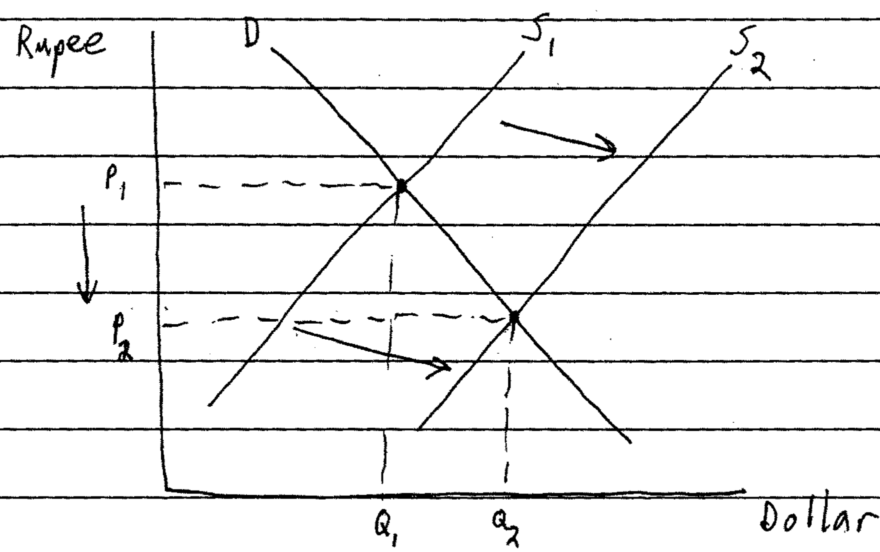
2B

(a) (i) Current account

(ii) capital account

(b) The US current account balance would ~~[scribbled]~~ decrease because the increased income would cause US citizens to purchase more foreign goods (imports increase).

(c)



The US dollar will depreciate relative to the Rupee because of the increase of the supply of the dollar in world markets.

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2

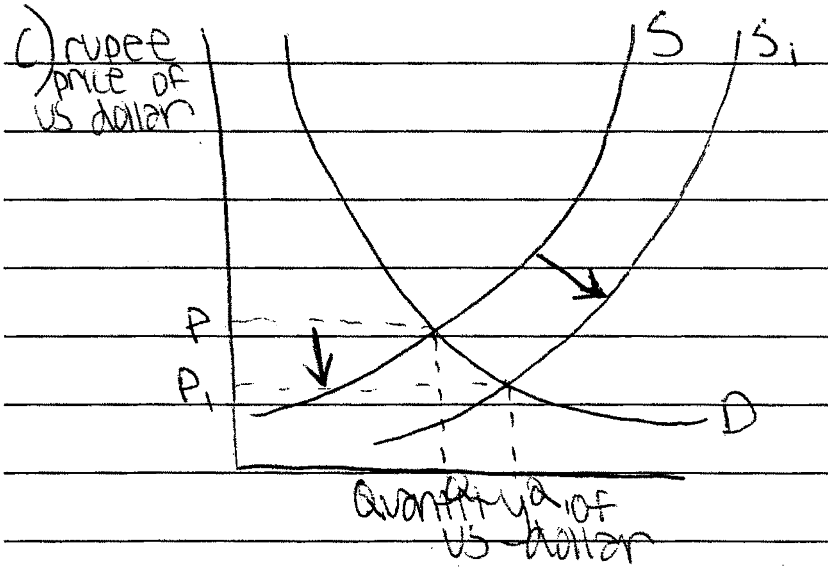
2C

a) i. If a US resident buys chocolate from Belgium it will be recorded within capital account

ii. If a US manufacturer buys computer equipment from Japan it will be recorded within capital account

b) An increase in the real income will increase the current account balance because ~~An~~ real GDP will go up because people will be able to consume more. However the balance of payments will remain the same at 0.

c)



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Question 2

Overview

This question tested students' understanding of the current and capital accounts in the balance of payments and the effect of a change in income on the current account. It also tested their ability to use a diagram of the foreign exchange market for the U.S. dollar to show the effect of an outflow of the dollar from the United States to India on the value of the dollar relative to Indian currency.

Sample: 2A
Score: 6

All parts are correctly answered.

Sample: 2B
Score: 4

The student lost 1 point in part (a)(ii) for incorrectly stating that computer equipment bought in Japan is recorded in the capital account. The student lost 1 point in part (c) for incorrectly labeling the Y axis.

Sample: 2C
Score: 2

The student lost 1 point in part (a)(i) for incorrectly stating that chocolate bought from Belgium will be recorded in the capital account and 1 point in part (a)(ii) for incorrectly stating that computer equipment bought in Japan is recorded in the capital account. In part (b) 1 point was lost for failing to state that imports increase, and 1 point was lost for incorrectly explaining that the current account balance will increase.

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