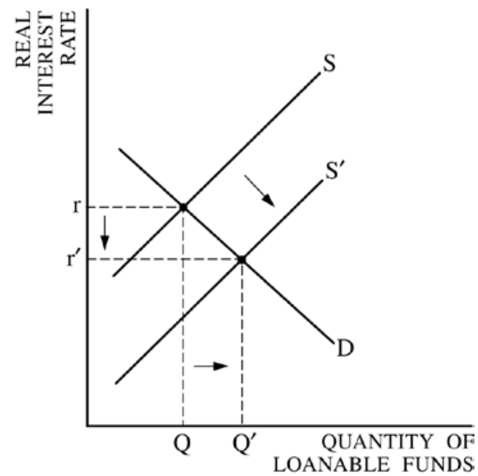
Question 2

6 points (3 + 3)



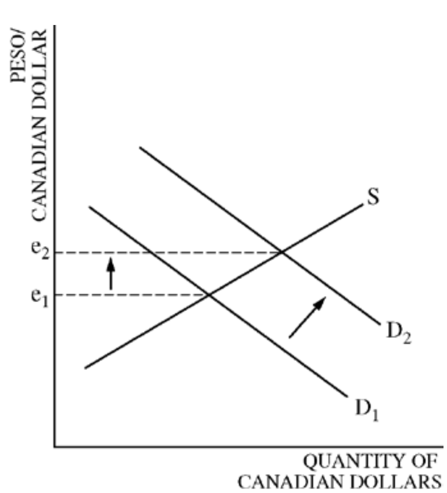
(a) (i) 1 point:

- One point is earned for drawing a correctly labeled graph of the loanable funds market and showing a rightward shift of the supply curve and the change in the real interest rate.

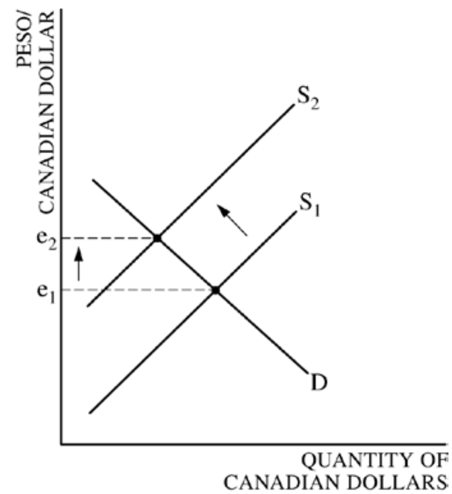
(ii) 2 points:

- One point is earned for stating that the decrease in the real interest rate caused interest-sensitive spending to increase.
- One point is earned for stating that the increase in aggregate demand increases output, which causes an increase in employment.

Question 2 (continued)



OR



(b) (i) 2 points:

- One point is earned for a correctly labeled graph of the foreign exchange market for the Canadian dollar.
- One point is earned for showing a rightward shift of the demand curve and/or a leftward shift of the supply curve and for showing an appreciation of the Canadian dollar.

(ii) 1 point:

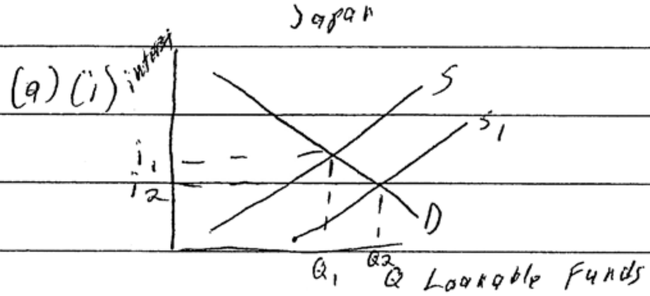
- One point is earned for stating that Canadian exports to Mexico will decrease because the appreciation of the Canadian dollar makes Canadian products more expensive for Mexican consumers.

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

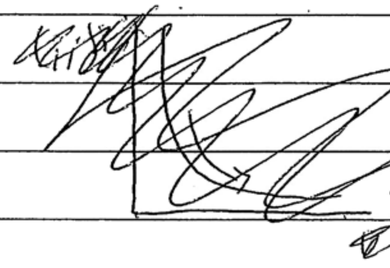
2

2A

(a) (i)



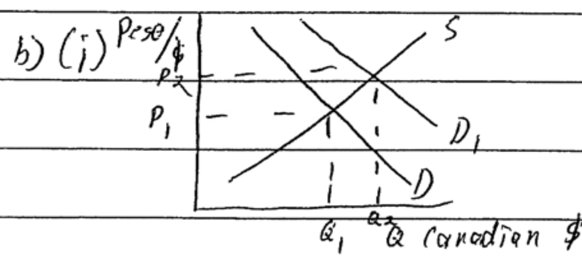
real interest rate decreases from i_1 to i_2.



~~As the interest rate decreases, unemployment increases, as indicated~~ by this short-run ~~Philips curve.~~

(ii) As interest rates go down, the employment level in Japan will go up because there will be a significant shift of Aggregate Demand to the right due to an increase in consumer spending (MPC increases due to low i), Investment spending (low i makes borrowing more attractive), and exports (the low interest rate will cause foreign investors to go elsewhere and forcing Japan's currency to depreciate, making their goods cheaper).

b) (i)



The value of the dollar will increase from $P_1 \to P_2$.

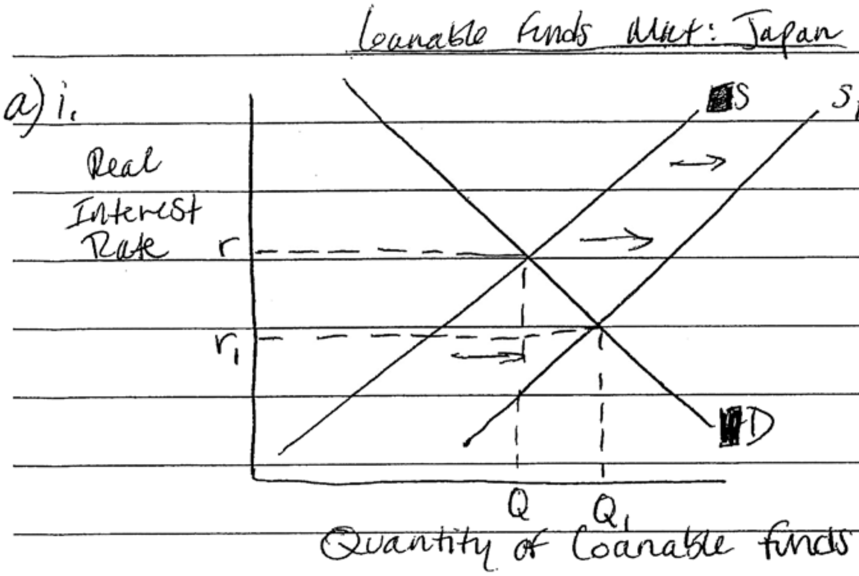
(ii) As the value of the Canadian dollar goes up, Canadian exports become more expensive for Mexico, so Mexico will not purchase as many Canadian goods. Canadian exports decrease.

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

2

2B 1of2

a) i.



As the Qty. of Loanable Funds moves from Q to Q_1, caused by an increase in foreign investment (shift to the right of the supply curve), rates fall from r to r_1.

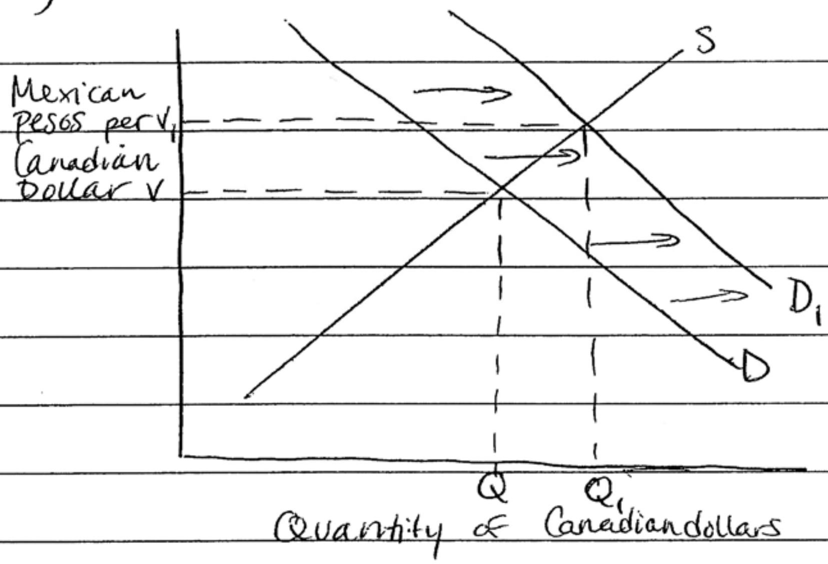
ii. Employment ~~increases~~ decreases. Aggregate supply shifts to the right, causing a reduction in price level. There is a short-run trade-off between inflation and unemployment. When inflation decreases, unemployment increases.

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

2

2B 2 of 2

b) i)



The increase in interest rate attracts foreign investors. Demand for Canadian dollar shifts to the right. The increased demand raises the value of the Canadian dollar from V pesos/dollar to V1 pesos/dollar. The canadian dollar has appreciated.

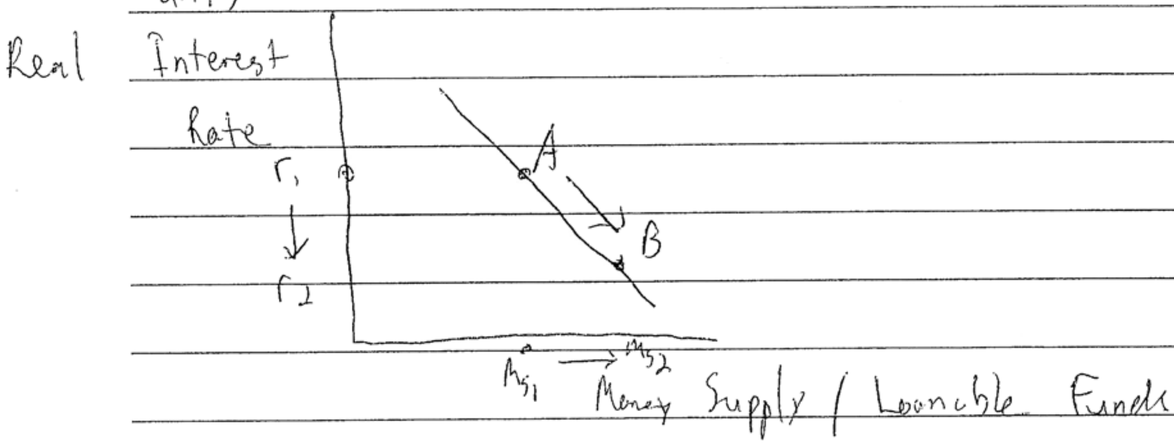
ii. Exports to mexico will decline. Because the peso depreciated compared to the Canadian dollar, Canadian exports are no relatively more expensive. Mexico can afford fewer exports.

2

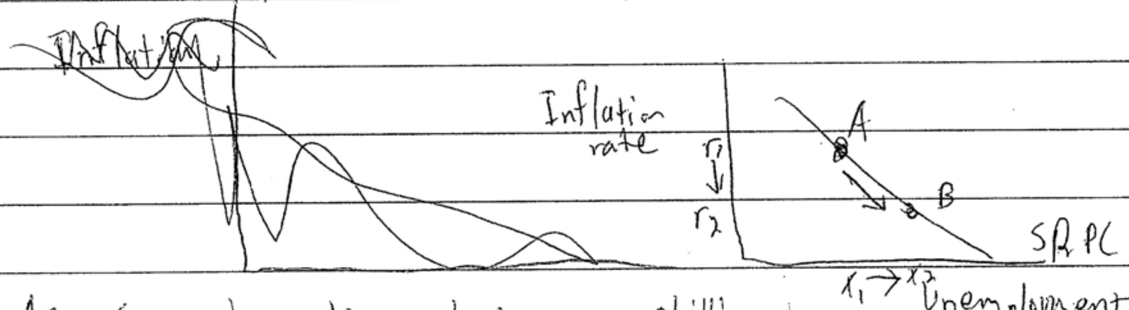
Write in the box the number of the question you are answering on this page as it is designated in the exam.

2C
1 of 2

2ai)



2aii) The decrease in interest rate in response to the increased amount of investment from the European Union will change the employment level in Japan in the short run. Since there a smaller interest rate, ~~W~~ a smaller inflation rate will result.

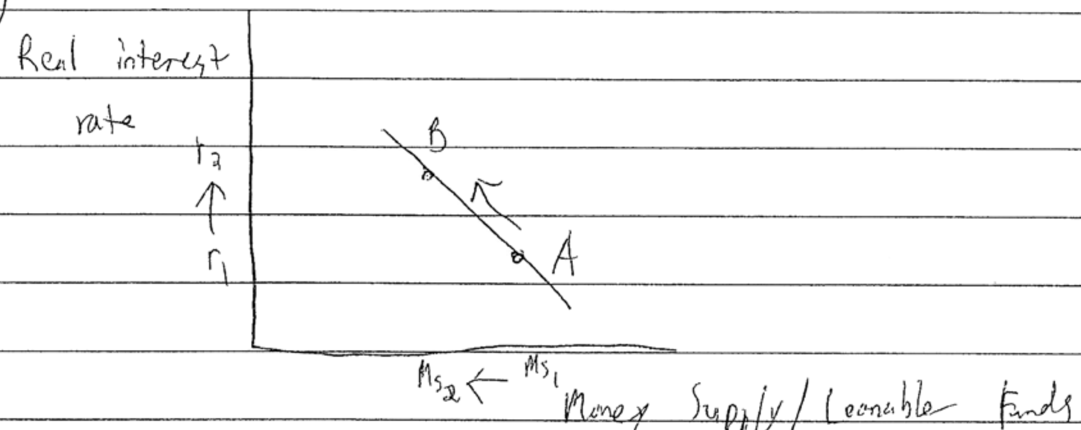


As seen in the short run phillips curve above, the decrease in the inflation ~~relation~~ rate will decrease the level of unemployment. Therefore, the decrease in the real interest rate of Japan will increase the employment level in Japan in the short run.

Write in the box the number of the question you are answering on this page as it is designated in the exam. 2

2C
2 of 2

2b i)



The Canadian dollar will appreciate as a resut of the increase in the real interest rate.

2b ii) The rise in the interest rate of the ~~Canadian~~ Canadian dollar relative to the Mexican peso will appreciate the Canadian dollar because more people will want to have Canadians dollars. Since the Canadian dollars will be more valuable compared to the Mexican peso, Mexicans will be able to afford less Canadian goods. As a result, the Canadian exports to Mexico will decrease from the appreciation of the Canadian dollar via the increase of Canada's real interest rate.

Question 2

Overview

Part (a) of this question determined students' ability to draw and manipulate the graph for the loanable funds market. Part (b) tested for understanding of the foreign exchange market, including the ability to model and interpret changes in the market.

Sample: 2A
Score: 6

The student answers all parts of the question correctly and so earned all 6 points.

Sample: 2B
Score: 4

The student earned 1 point in part (a)(i). In part (b)(i) the student earned 1 point for drawing a correctly labeled graph of the market for Canadian dollars and 1 point for shifting the demand curve to the right and indicating the resulting appreciation of the Canadian dollar. One point was earned in part (b)(ii) for stating that Canadian exports to Mexico will decrease because "Canadian exports are no[w] relatively more expensive."

Sample: 2C
Score: 1

The student earned 1 point in part (b)(ii) for stating that the appreciation in the Canadian dollar will cause Canadian exports to Mexico to decrease, because "Mexicans will be able to afford less Canadian goods."