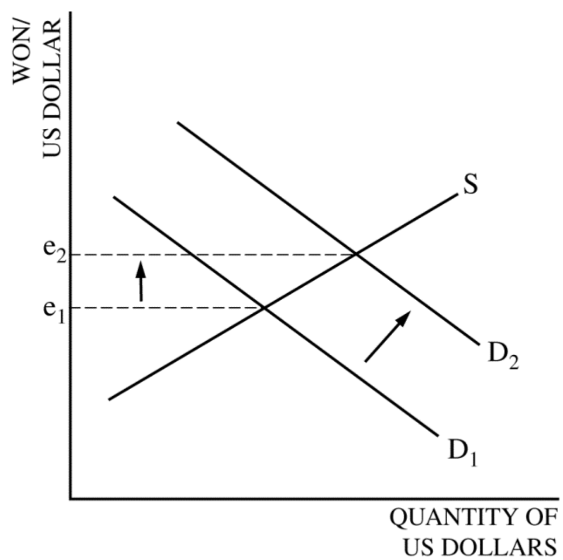
Question 3

5 points (1+2+2)

(a) 1 point:
- One point is earned for stating that United States exports to South Korea will increase.

(b) 2 points:
- One point is earned for stating that the United States current account will be in surplus.
- One point is earned for stating that the United States gross domestic product will increase and explaining that higher U.S. exports increase AD (or that production increases to meet the increased export demand from South Korea).



(c) 2 points:
- One point is earned for drawing a correctly labeled graph of the foreign exchange market for the U.S. dollar.
- One point is earned for shifting the demand curve for the dollar to the right (and/or shifting the supply curve to the left) and showing an increase in the won price per dollar.

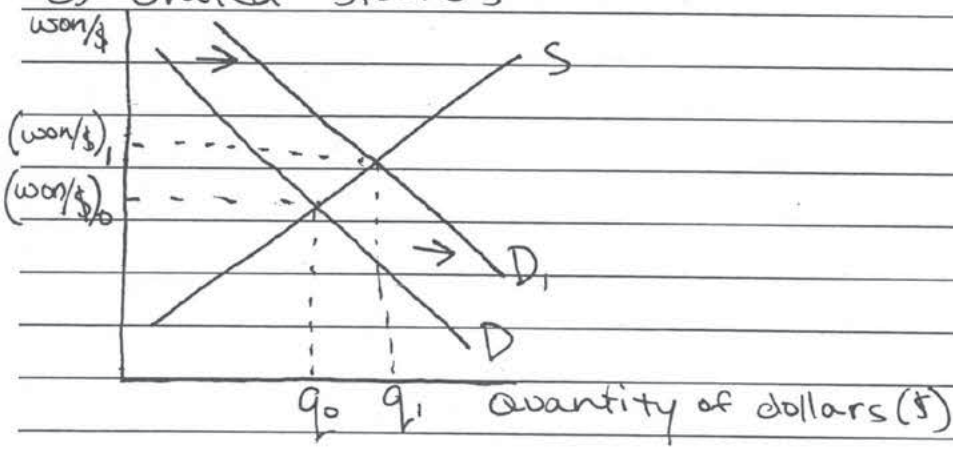
ANSWER PAGE FOR QUESTION 3

a) Increase

b) i) Surplus

~~$~~ ii) Real Gross Domestic Product in the United States will increase as exports increase. Net exports are a component of aggregate demand and if the United states increases it's exports, aggregate demand ~~inc~~ increases, which increases Real gross domestic product.

c) United States



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3B

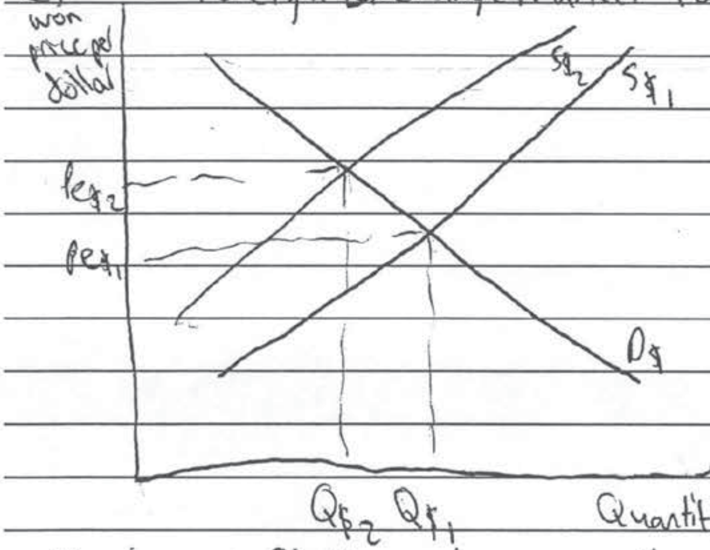
ANSWER PAGE FOR QUESTION 3

A) The number of exports from the U.S. to South Korea will decrease because of the appreciated U.S. dollar.

B)(i) The U.S. current account will enter a deficit because it will export less.

(ii) In the short run the U.S. real GDP will decrease because it is exporting less.

C) Foreign Exchange Market for U.S. Dollar



The lower inflation rate causes the won to depreciate in value compared to the U.S. dollar.

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ANSWER ~~PAGE FOR~~ QUESTION 3

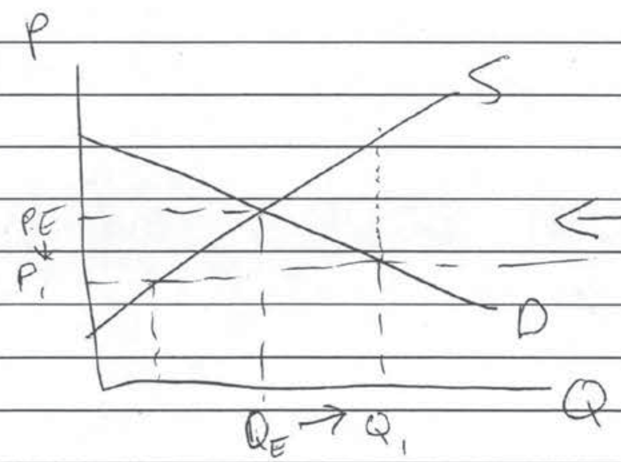
3C

a) decrease ~~increase~~

b) i. be in deficit

ii. it will decrease because decreasing inflation will cause the money to be worth more, so less money will be spent.

c)



Price of won will go down

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Question 3

Overview

The question asked students to identify, explain, and show some of the international effects of a decrease in the inflation rate in the United States relative to the inflation rate in South Korea. Part (a) asked students to identify the effect of the lower relative inflation rate in the United States on exports from the United States. Part (b) required students to identify the effect of the change in United States exports identified in part (a) on the current account balance and on real gross domestic product. In part (c) students were asked to draw a graph of the foreign exchange market for the United States dollar and show the effect of the lower relative inflation rate in the United States on the United States exchange rate.

Sample: 3A
Score: 5

The response answered all parts of the question correctly.

Sample: 3B
Score: 3

The response did not earn 1 point in part (a) for stating that United States exports to South Korea will decrease. The response earned 1 point in part (b)(i) for answering consistently with part (a) that the current account balance will move toward deficit with a decrease in exports. The response did not earn 1 point in part (b)(ii) for failing to include an adequate explanation for the change in real gross domestic product.

Sample: 3C
Score: 1

The response earned 1 point in part (b)(i) for answering consistently with part (a) that the current account balance will be in deficit with a decrease in exports.