AP® Macroeconomics
2002 Sample Student Responses

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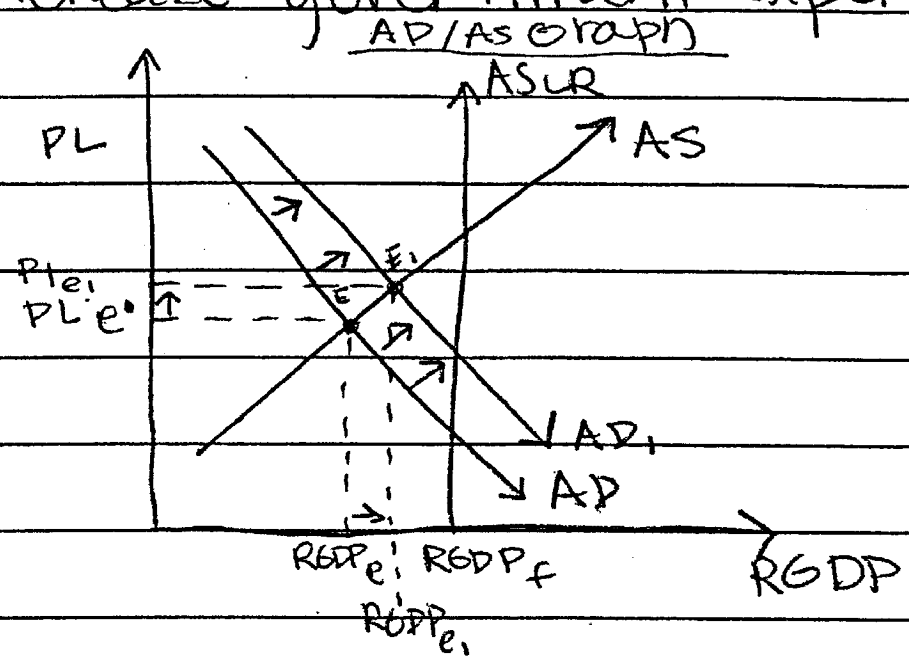
1MAC CLA.

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

1

a. increase government expenditures

b.



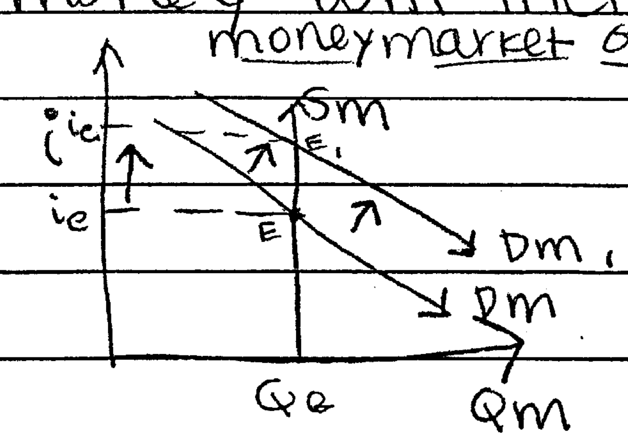
(i) ↑G => ↑AD to AD_1 => ↑$RGDP_e$ to $RGDP_{e_1}$

SO . . . output ↑

(ii) ↑G => ↑AD to AD_1 => ↑PL to PL_{e_1}

SO . . . PL↑

c. With increased goverment expenditures the government will have deficit spending and need to borrow money, this increase in the demand for money will increase interest rates.



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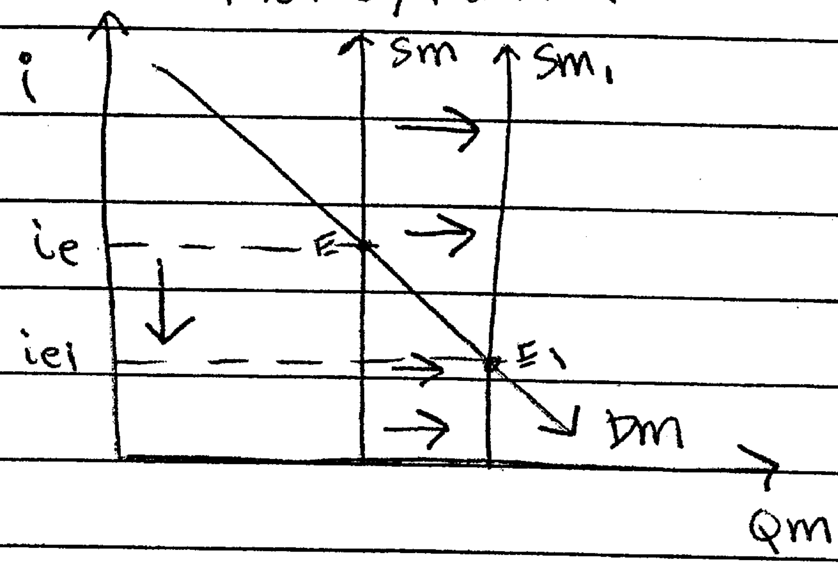
1

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

d. The Federal Reserve can buy bonds.

e. Money Market

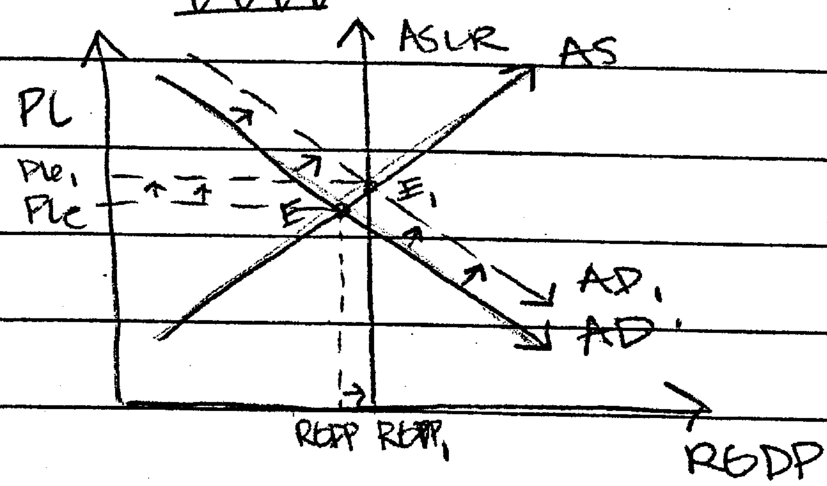


(i) ↑ Sm to Sm_1 => ↓ i to ie_1

So . . . Interest rates ↓

(ii)

AS/AD graph



↓ i => ↑ Ig => ↑ AD to AD_1 => ↑ RGDP to $RGDP_1$

So . . . output ↑

(iii) ↓ i => ↑ Ig => ↑ AD to AD_1 => ↑ Pl to Ple_1

So.. Price level ↑

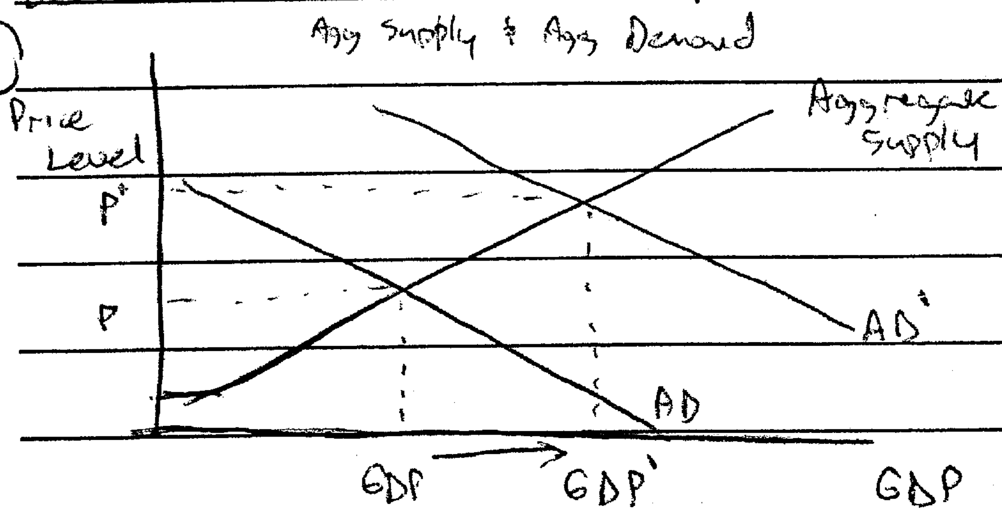
1MACCLJ,

Question 1

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

(a) Since the U.S. is experiencing high unemployment they could reduce taxes to counteract it. By reducing taxes, people's disposable income will increase. With greater disposable income comes greater consumption possibilities. This increase in consumption ~~...~~ increases the ~~...~~ Aggregate demand since it is a component of it. [~~...~~ AD = C + I + G + (X−M)]. This increases in aggregate demand will increase output (GDP) and increase employment.

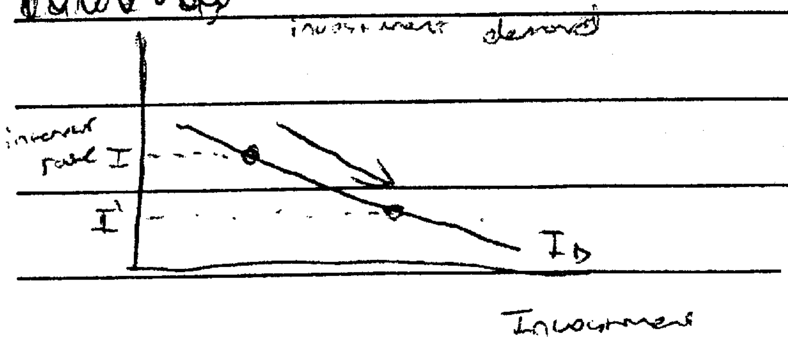
(b)



(i) The output will increase due to the new equilibrium position created by the increase of Aggregate Demand (GDP ⟶ GDP').

(ii) The overall price level will also increase due to the new equilibrium position ~~...~~ caused by the shift in AD. (P — P')

(c) Short term interest rates will ~~...~~ decrease, this is shown by the graph below. More investment (from higher disposable income) ~~...~~ moves the position ~~...~~ along the curve ~~...~~



1MACCLJ2

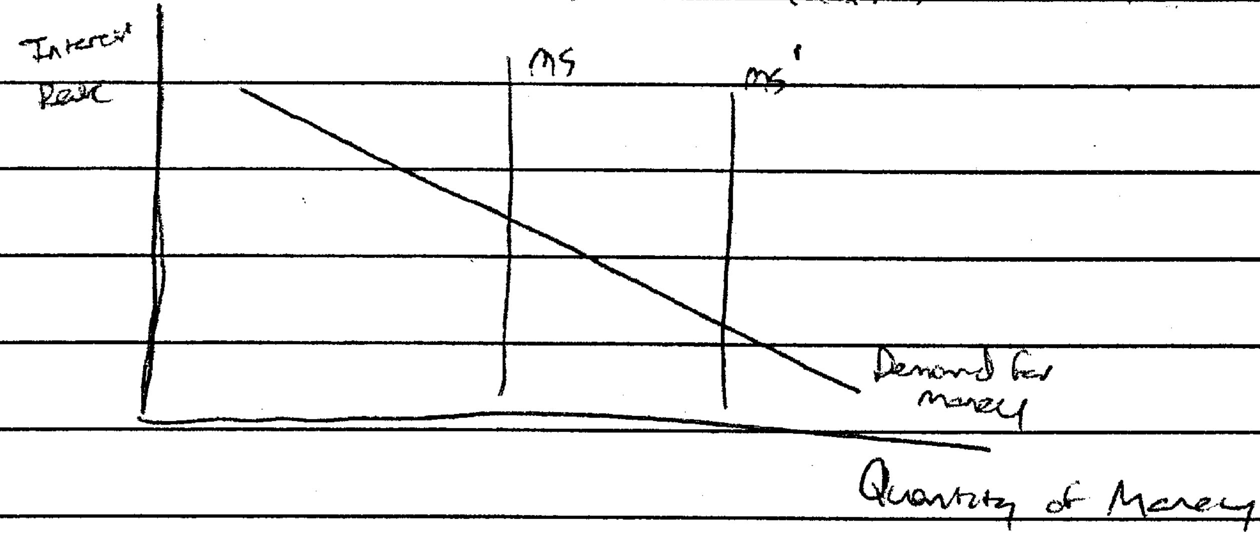
Write in the box the number of the question you are answering on this page as it is designated in the examination.

Question 1

(d) Using open market policy the Federal Reserve should buy bonds, thus increasing the money supply.

Interest Rate vs Money Supply

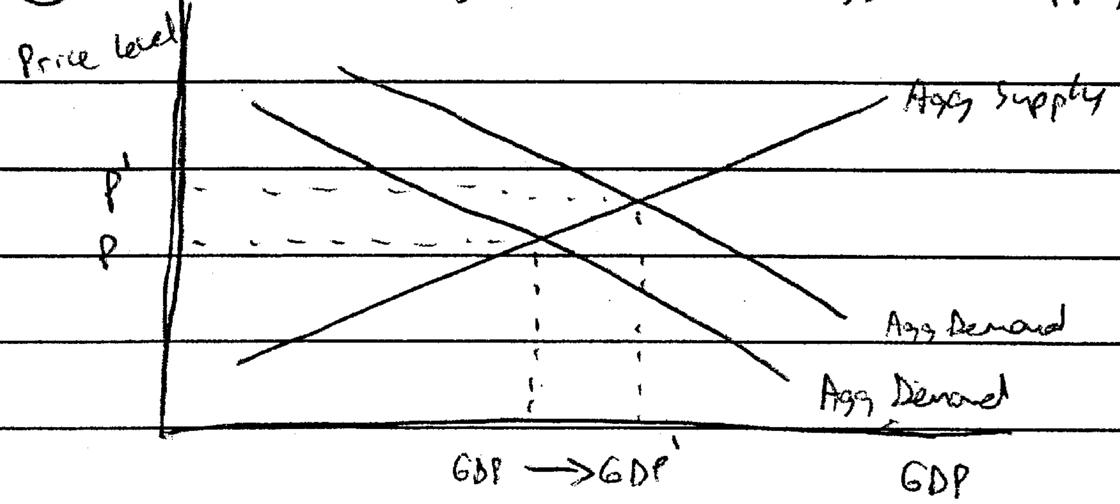
(e) (i)



• The increase in the money supply will lower the short term interest rates.

(ii)

Aggregate demand and aggregate supply



• The increased money supply creates lower interest rates. This, in turn, makes borrowing money more appealing (↓ interest rate). Investment can then increase, and since it's a component of aggregate demand, aggregate demand will increase. The new equilibrium position shows the increase in GDP from GDP to GDP'.

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Question 1

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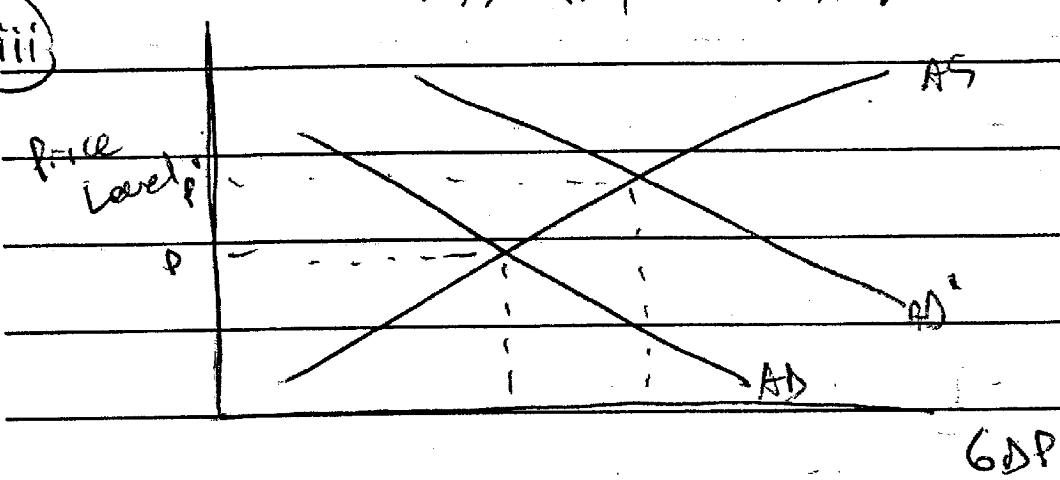
~~Agg Supply vs Agg Demand~~

iii



• As noted in (ii) the aggregate demand curve increase because of increased investment (↓ interest rates). This creates a new equilibrium with increased price. [P – P']