

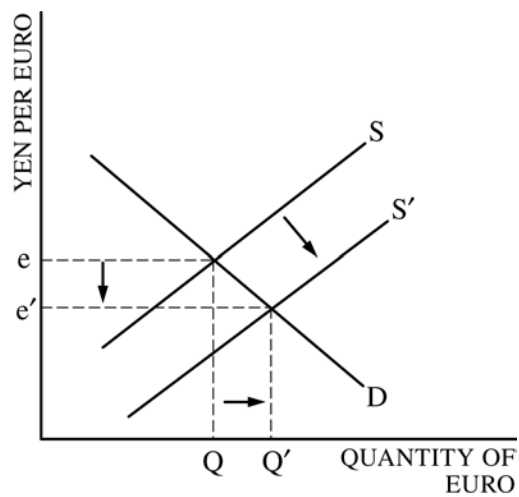
AP[®] MACROECONOMICS 2015 SCORING GUIDELINES

Question 3

6 points (2+3+1)

(a) 2 points:

- One point is earned for stating that the real interest rate in Japan will increase in the short run because the supply of loanable funds will decrease or the demand for loanable funds will increase.
- One point is earned for stating that private domestic investment in plant and equipment in Japan will decrease.



(b) 3 points:

- One point is earned for drawing a correctly labeled graph of the foreign exchange market for the euro.
- One point is earned for showing that the supply curve for euros shifts to the right and for concluding that the yen price of the euro decreases.
- One point is earned for explaining that the European purchases of Japanese financial assets will increase due to the relatively higher rate of return in Japan.

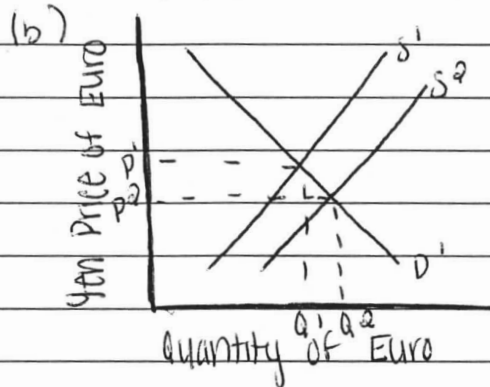
(c) 1 point:

- One point is earned for stating that European Central Bank should buy euros.

ANSWER PAGE FOR QUESTION 3

(a) i. Real Interest Rates in the short run will increase because an increase in government budget deficit spending causes the demand for loanable funds to shift right which ~~causes~~ causes real interest rates to increase.

ii. private domestic investment in plant and equipment, also known as business ~~investment~~ investment spending will decrease because interest rates are increased.



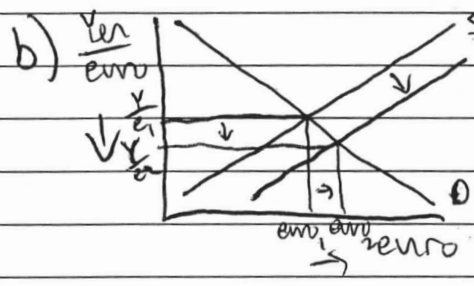
i. The supply of Euro in the foreign exchange market will increase because when real interest rates in Japan increased, people with euro's will want to invest in Japan's financial assets because they will see a higher return. To purchase Japan's financial assets, they will demand Yen from the foreign exchange market, leaving behind euro.

(c) The European Central Bank should buy euros in the foreign exchange market to reverse the change in the yen price of the Euro.

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3B,

- 3) a) i) Real interest rate \uparrow b/c increase government spending on investment
 ii) Private domestic investment in plant and equipment \downarrow



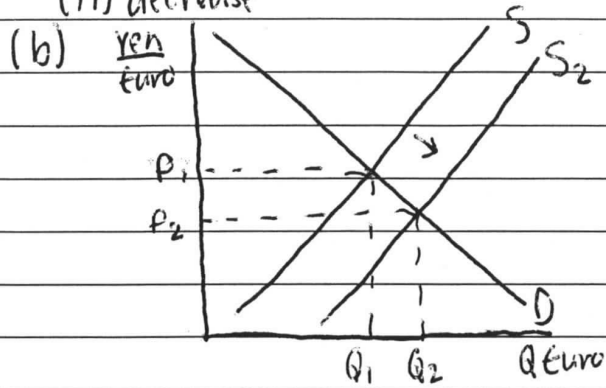
- i) Supply of euro increase b/c buying more yen with euros b/c Japan BHT
 ii) Yen price of euro \downarrow

c) buy

ANSWER PAGE FOR QUESTION 3

(a)(i) increase in budget deficit leads to more money supply which lowers the interest rate

(ii) decrease



(i) supply of euros will increase because of the lowered interest rate

(ii) decrease

(c) sell euros

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AP[®] MACROECONOMICS
2015 SCORING COMMENTARY

Question 3

Overview

The question focused on the effect of an increased government budget deficit on the interest rate and the exchange rate. Part (a) asked students to explain the effect of Japan's increased government budget deficit on the real interest rate in the short run in Japan and indicate the effect of the increased government budget deficit on private domestic investment in plant and equipment in Japan. Part (b) required students to draw a correctly labeled graph of the foreign exchange market to show the effect of the change in the real interest rate identified in part (a) on the supply of euros and the yen price of the euro, and to explain the effect of the real interest rate change on the supply of euros. Part (c) asks whether the European Central Bank should buy or sell euros in order to reverse the change in the yen price of the euro indicated in part (b).

Sample: 3A

Score: 6

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

Sample: 3B

Score: 4

The student did not earn 1 point in part (a)(i) for failing to explain why the real interest rate increased. The student did not earn 1 point in part (b)(i) for failing to explain why the supply curve for euros shifted to the right.

Sample: 3C

Score: 2

The student earned 1 point in part (a)(ii) for correctly stating that private domestic investment would decrease. The student earned 1 point in part (b)(i) for showing a correctly labeled graph of the foreign exchange market for the euro. Note: The student was not awarded the second point in part (b)(i) because the shift of the supply curve of euros was inconsistent with the answer provided in part (a)(i).