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## Essay

1.

Assume that the United States economy is operating at full employment.

(a) Using a correctly labeled graph of the long-run aggregate supply, short-run aggregate supply, and aggregate demand, show each of the following.

(i) Current price level, labeled $PL_1$

(ii) Current output level, labeled $Y_1$

(b) Assume that personal savings in the United States increase. Using a correctly labeled graph of the loanable funds market, show the impact of the increase in personal savings on the real interest rate.

(c) Based on the real interest rate change identified in part (b),

(i) will interest-sensitive expenditures increase, decrease, or remain unchanged?

(ii) what will happen to the rate of economic growth? Explain.

(d) Assume that the real interest rate of the euro zone increases relative to the real interest rate of the United States. Draw a correctly labeled graph of the foreign exchange market for the euro and show the impact of the change in the real interest rate in the euro zone on each of the following.

(i) Demand for the euro. Explain.

(ii) Value of the euro relative to the United States dollar

(e) Assume that the United States current account balance is zero. Based on the change in the value of the euro identified in part (d)(ii), will the United States current account balance now be in surplus, be in deficit, or remain at zero?

2.

The unemployment rate is an important indicator of the health of the United States economy.

(a) Assume that with the economy at full employment, the government implements an expansionary fiscal policy. How does the actual unemployment rate at the new short-run equilibrium compare with the natural rate of unemployment?

(b) Assume that a significant number of workers are involuntarily changed from full-time to part-time employment. Explain how this will affect the number of people who are officially classified as unemployed.

(c) Assume that the government reduces the level of unemployment compensation.

(i) Explain how this affects the natural rate of unemployment.

(ii) Using a correctly labeled graph, show how this affects the long-run Phillips curve.