3. Assume that the economy of country Zen is in long-run macroeconomic equilibrium.

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

(i) The current equilibrium real output and price level, labeled Y_1 and PL_1, respectively

(ii) The full-employment output, labeled Y_F

(b) On your graph in part (a), show the short-run effect of an increase in consumer confidence. Label the new equilibrium real output Y_2 and the new equilibrium price level PL_2.

(c) Assume that the banking system in Zen has ample reserves. Suppose that the central bank's goal is to maintain a stable price level at PL_1. Based on the change in the price level shown in part (b), identify one specific monetary policy action the central bank would take to achieve its goal.

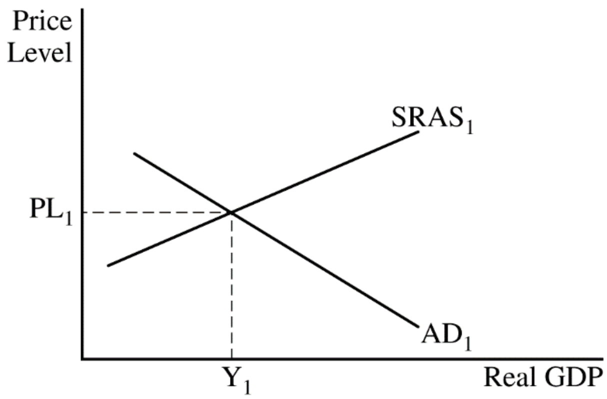
(d) Based on the monetary policy action identified in part (c), will real output increase, decrease, or stay the same in the short run? Explain.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

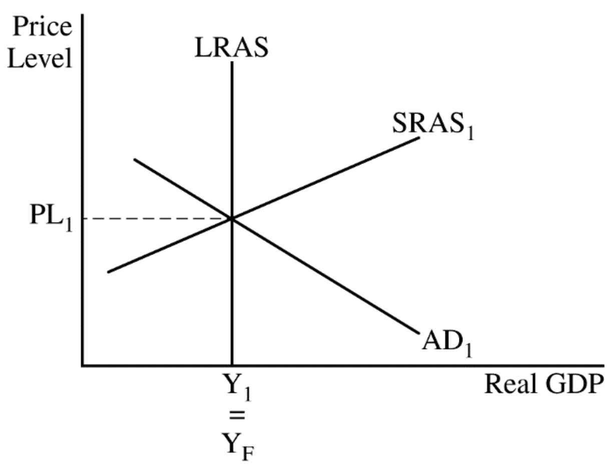
GO ON TO THE NEXT PAGE.

Question 3: Short — 5 points

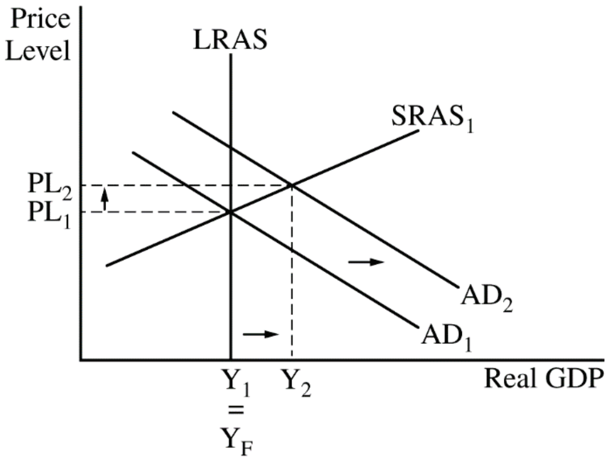
(a) Draw a correctly labeled aggregate demand–aggregate supply graph that shows PL_1 and Y_1 at the intersection of aggregate demand and short-run aggregate supply. **1 point**



For the second point, the graph must show a vertical long-run aggregate supply curve at equilibrium real output $Y_1 = Y_F$. **1 point**



Total for part (a) 2 points

(b)	On the graph from part (a), show the short-run effect of the increase in consumer confidence as a rightward shift of the aggregate demand curve, resulting in an increase in real output, labeled Y_2, and an increase in the price level, labeled PL_2. 	**1 point**
(c)	State that the central bank would increase its administered interest rates or increase interest on reserves.	**1 point**
(d)	State that real output will decrease and explain that the increase in interest rates will decrease interest-sensitive spending (consumption, investment, or net exports), which decreases aggregate demand.	**1 point**

Total for question 3 5 points