3. Assume Malaysia's economy is in a recession and its government currently has a balanced budget.

   (a) Identify a specific fiscal policy action that the government of Malaysia would implement to address the recession.

   (b) How will the fiscal policy action identified in part (a) affect the real interest rate in Malaysia? Explain.

   (c) Malaysia and Japan are trading partners with flexible exchange rates. Malaysia's currency is the ringgit (MYR), and Japan's currency is the yen (JPY). Draw a correctly labeled graph of the foreign exchange market for the ringgit relative to the yen. Show the effect of the change in the real interest rate identified in part (b) on the international value of the ringgit.

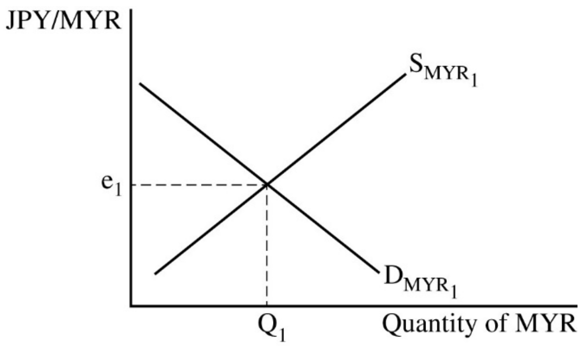
   (d) As a result of the change in the value of the ringgit shown in part (c), will Malaysia's imports increase, decrease, or remain the same? Explain.

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.

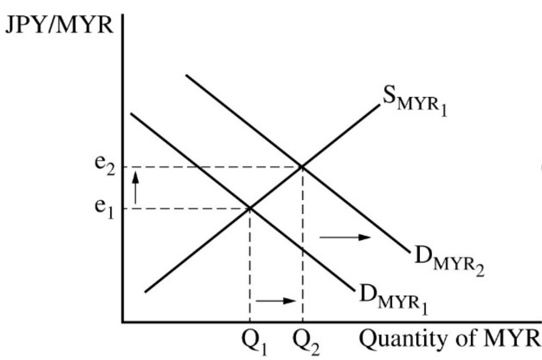
GO ON TO THE NEXT PAGE.

Question 3: Short — 5 points

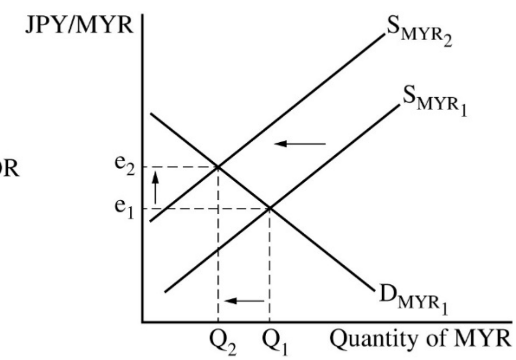
(a)	State an increase in government spending, a decrease in taxes, or an increase in transfer payments.	**1 point**
(b)	State that the real interest rate will increase and explain that government borrowing will increase, which will increase the demand for loanable funds (or decrease the supply of loanable funds).	**1 point**
(c)	Draw a correctly labeled graph of the foreign exchange market for the ringgit.	**1 point**



For the second point, the graph must show an increase in the demand for the ringgit (or a decrease in the supply of the ringgit), resulting in an appreciation of the ringgit.	**1 point**



OR



	Total for part (c)	**2 points**
(d)	State that Malaysia's imports will increase and explain that the appreciation of the ringgit will make Japanese goods relatively less expensive than they were before.	**1 point**
	Total for question 3	**5 points**