1. Assume that the economy of Vortania is in long-run equilibrium.

A. Draw a correctly labeled graph of the short-run and long-run Phillips curves for the economy of Vortania, and label the long-run equilibrium point as P.

B. Assume that new residential construction projects are being implemented in Vortania.

i. Will real output in Vortania increase, decrease, or remain the same in the short run? Explain.

ii. Assuming no change in inflationary expectations, on your graph in part A, show the short-run effect of the new residential construction projects on Vortania's economy, labeling the new short-run equilibrium point as S.

C. Vortania and Rhodara are trading partners with flexible exchange rates. The currency of Vortania is the Vortanian crown (VTC), and the currency of Rhodara is the Rhodaran mark (RHM). Assume that Vortania's capital and financial account (CFA) balance is zero. Now assume that Vortania imposes new tariffs on imports from Rhodara. Draw a correctly labeled graph of the foreign exchange market for the Vortanian crown, and show the effect of the tariffs on the SUPPLY of the Vortanian crown and the international value of the Vortanian crown.

D. Based solely on the change in the international value of the Vortanian crown shown in part C, will Vortania's net exports increase, decrease, or remain the same in the short run?

E. Based on the change in net exports identified in part D, what will happen to each of the following in the short run?

i. The capital and financial account (CFA) balance in Vortania. Explain.

ii. Employment in Vortania

F. Assume the central bank of Vortania wants to return the Vortanian crown to its international value before the imposition of the tariffs. Would the central bank buy or sell Vortanian crowns in the foreign exchange market? Explain.

2. The economies of Country L and Country A are currently in short-run equilibrium at output levels below full employment. Both countries intend to use monetary policy to close their output gaps. Country L has a banking system with limited reserves, and Country A has a banking system with ample reserves.

A. What open-market operation would Country L implement to move the economy toward full employment in the short run?

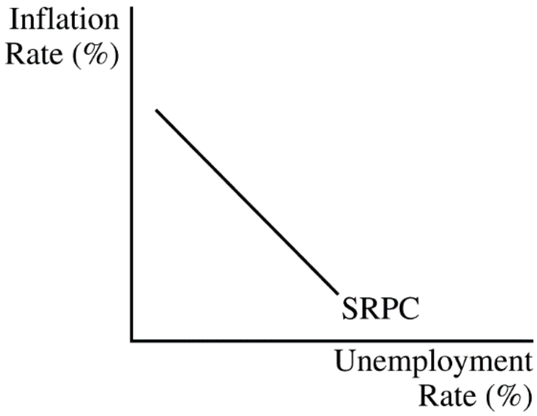
B. What specific monetary policy action would Country A implement to move the economy toward full employment in the short run?

C. Draw a correctly labeled graph of the reserve market in Country A, and show the effect of the monetary policy action identified in part B on the policy rate.

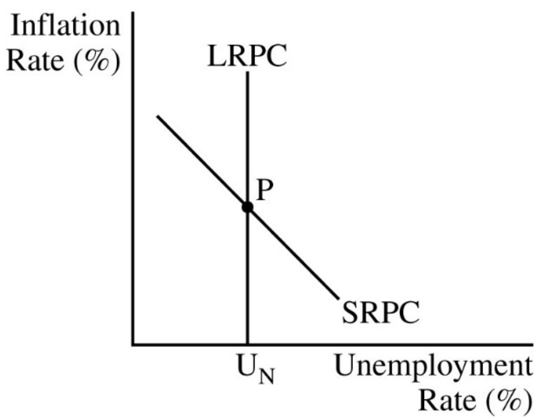
D. Assume instead that no policy actions are taken in Country A and that the economy remains in short-run equilibrium at an output level below full employment. Will short-run aggregate supply in Country A increase, decrease, or remain the same as the economy self-adjusts in the long run? Explain.

Question 1: Long — 10 points

A Point 1 — Draw a correctly labeled graph of the short-run Phillips curve (SRPC). **1 point**



Point 2 — The graph must include a correctly labeled long-run Phillips curve (LRPC) and show a point labeled P at the intersection of the short-run and long-run Phillips curves. **1 point**



B (i) Point 3 — State that real output will increase and explain that the new residential construction projects increase investment spending, which increases aggregate demand. **1 point**

(ii) Point 4 — On the graph from part A, show a point labeled S on the SRPC to the left of point P. **1 point**