



# Macroeconomics Unit 5

## Free Response Questions

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**FRQ #1-** Assume that the Canadian economy is currently in a short-run equilibrium and the natural rate of unemployment is below the actual unemployment rate.

- Draw a correctly labeled graph with both the short-run Phillips curve and long-run Phillips curve. Label the current short-run equilibrium point Y.
- Assume that the United States, a major trading partner for Canada, experiences a recession. Show the short-run effect on your graph in part (a) and label the new short-run equilibrium point Z.
- Assume that the government of Canada influences government spending to achieve full employment.
  - In the short run, will the real interest rate increase, decrease, or stay the same? Explain.
  - Based on the real interest rate change in part (c)(i), what is the effect on the long-run economic growth rate?
- Now assume that the Canadian economy returns to long-run equilibrium and that the central bank increases the money supply. What will happen to each of the following in the long run?
  - The inflation rate.
  - The unemployment rate. Explain.

**FRQ #2-** Assume that the economy of Country X has an actual inflation rate of 8%, an unemployment rate of 2%, a natural rate of unemployment of 5%.

- Draw a correctly labeled graph of the short-run and long-run Phillips curves. Label the current short-run equilibrium as point A. Plot the numerical values above on the graph.
- Assume that the government and central bank of Country X take no policy actions.
  - Explain how the economy will adjust to full employment in the long run.
  - On your graph in part (a), show the adjustment you identified in part (b)(i) and label the long-run equilibrium as point B.
- Assume instead that the government of Country X decides to use fiscal policy to achieve full employment.
  - Would the inflation rate after using fiscal policy be greater than, less than, or equal to the inflation rate at point B.
  - Will the fiscal policy move the government of Country X toward a budget surplus or a budget deficit?
- Assume that the government expands unemployment benefits and increases compensation for the employed. What effects will this policy have on the long-run Phillips curve? Explain.