

Unit 6 Progress Check: FRQ

1. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. If the question prompts you to “Calculate,” you must show how you arrived at your final answer.

Japan and the United States are major trading partners and the exchange rate between the Japanese yen and the United States dollar is determined in a flexible foreign exchange market.

(a) Assume real income increased in the United States. Draw a correctly labeled graph of the foreign exchange market for the yen, and show the effect of the increased real income in the United States on the equilibrium exchange rate for the yen.

(b) Will each of the following increase, decrease, or stay the same as a result of the increase in the United States real income?

(i) Japan’s net exports. Explain.

(ii) Unemployment in Japan. Explain.

(iii) Japan’s long-run aggregate supply

(c) Assume instead household savings increased in the United States. Draw a correctly labeled graph of the loanable funds market in the United States, and show the effect of the increase in household savings on the equilibrium real interest rate.

(d) Based on the change in the equilibrium real interest rate identified in part (c), what will happen to financial capital flows to the United States?

(e) Based on your answer to part (d), what will happen to the international value of the dollar in the foreign exchange market? Explain.

(f) Based on your answer to part (e), will the Federal Reserve buy or sell yen in the foreign exchange market to stabilize the dollar/yen exchange rate? Explain.



Please respond on separate paper, following directions from your teacher.

Part (a)

Select a point value to view scoring criteria, solutions, and/or examples and to score the response.



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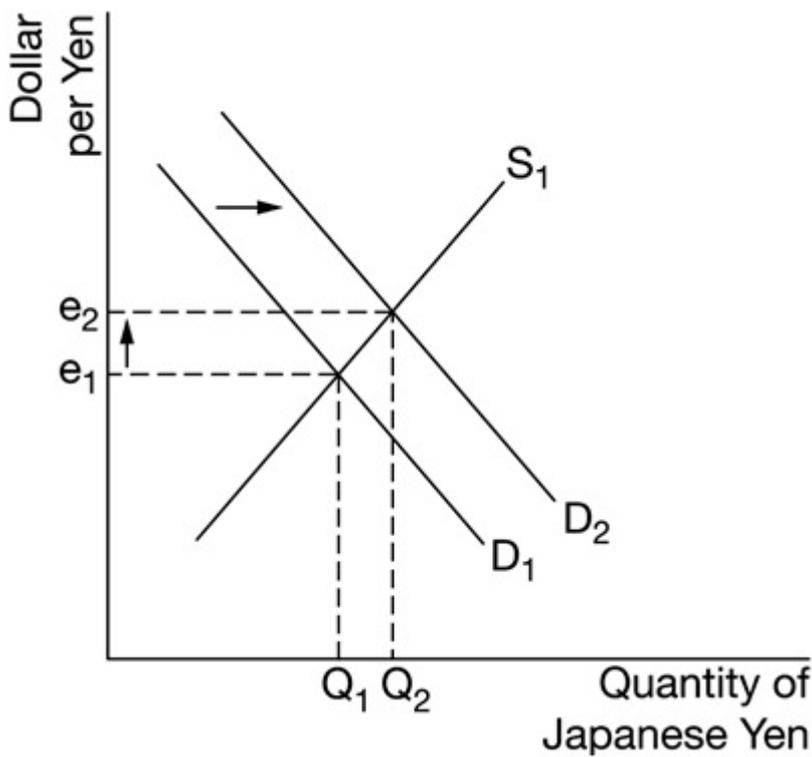
The response accurately includes both of the criteria below.

- Draws a correctly labeled graph of the foreign exchange market for the Japanese yen.
- Shows a rightward shift of the demand curve for the Japanese yen and an appreciation of the yen.

OR

Shows a leftward shift of the supply curve of the Japanese yen and an appreciation of the yen.

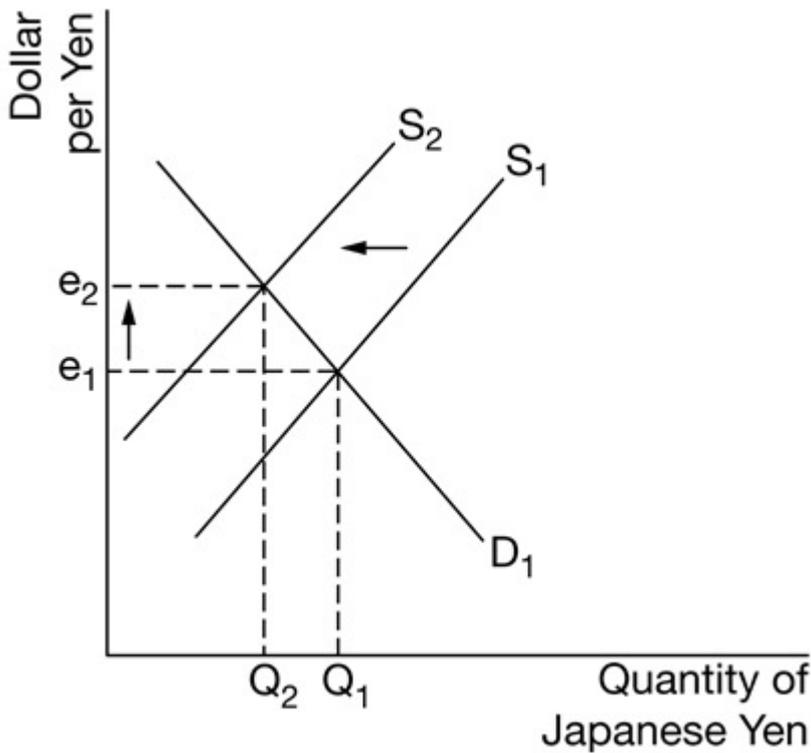
Solution



OR



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Part (b)

Select a point value to view scoring criteria, solutions, and/or examples and to score the response.



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The response accurately includes all three of the criteria below.

- States that Japan’s net exports will increase and explains that the United States demand for Japanese goods will increase, which increases Japan’s exports.
- States that unemployment in Japan will decrease and explains that the increase in Japan’s net exports will increase aggregate demand in Japan, which will increase real output and employment.
- States that Japan’s long run aggregate supply will stay the same.

Part (c)



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Select a point value to view scoring criteria, solutions, and/or examples and to score the response.

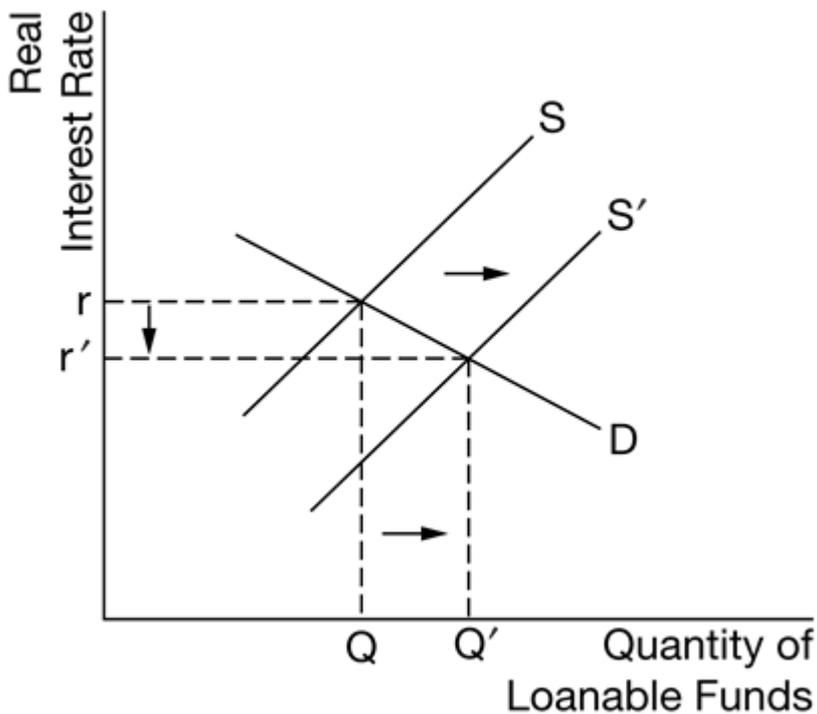


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The response accurately includes both of the criteria below.

- A correctly labeled graph of the loanable funds market.
- A rightward shift of the supply of loanable funds curve and a decrease in the real interest rate.

Solution



Part (d)

Select a point value to view scoring criteria, solutions, and/or examples and to score the response.

The response should be consistent with the change in the equilibrium real interest rate identified in part (c).



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The response states that there will be financial capital outflows.

Part (e)

Select a point value to view scoring criteria, solutions, and/or examples and to score the response.

The response should be consistent with the change in financial capital flows identified in part (d).

The response must both state that the dollar will depreciate and explain why in order to receive the point.



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The response states that the dollar will depreciate and explains that financial capital will flow out of the United States seeking higher returns on financial investments in foreign countries, which will result in a decrease in the demand for the dollar or an increase in the supply of the dollar.

Part (f)

Select a point value to view scoring criteria, solutions, and/or examples and to score the response.

The response should be consistent with the change in the international value of the dollar identified in part (e).

The response must both state that the Federal Reserve will sell yen and explain why in order to receive the point.



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The response states that the Federal Reserve will sell yen in the foreign exchange market and explains that selling yen in the foreign exchange market will increase the supply of the yen and increase the demand for the dollar, which causes an appreciation of the dollar against the yen.



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