

AP Macroeconomics Series: Preparing for Unit 6 FRQs

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Intro

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About me....

- married 25+ years, two sons, two dogs
- 25 years at Mounds View High School
- *Beat Boredom (2018)*
- NeverBore consulting, blog (MarthaRush.org)
- AP reader since 2007 (Macro & Micro) and consultant since 2016
- CEE contributor (HS Econ, EconEdLink)
- National Econ Challenge coach
- Hobbies: Travel, reading, tennis, swimming, craft beer



Unit 6 Topics on FRQs

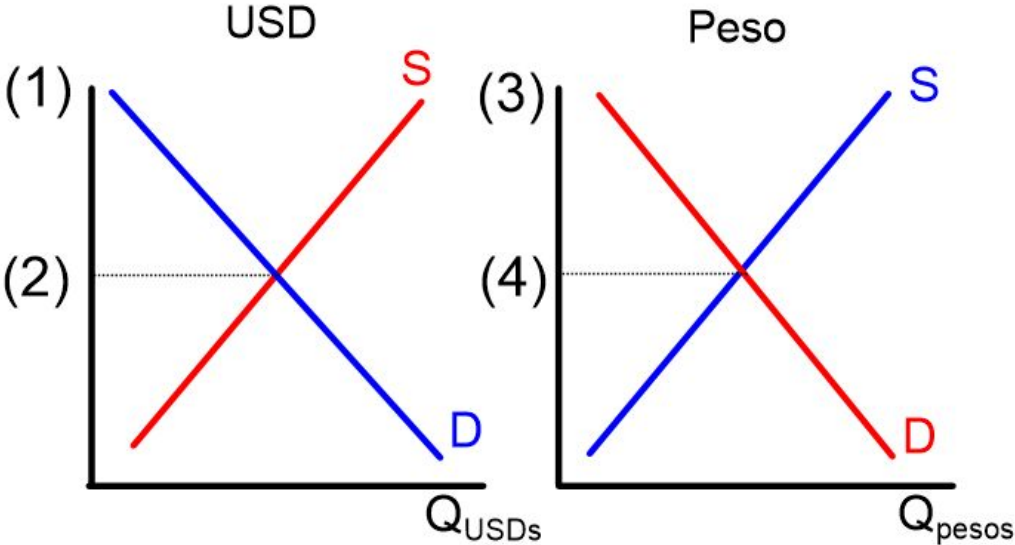
- *Comparative Advantage
- Balance of Payments Accounts
- For-Ex Markets
- Imports and Exports

These are sometimes short, stand-alone FRQs and sometimes integrated in other topics. Students should be prepared for both.

Key Tips

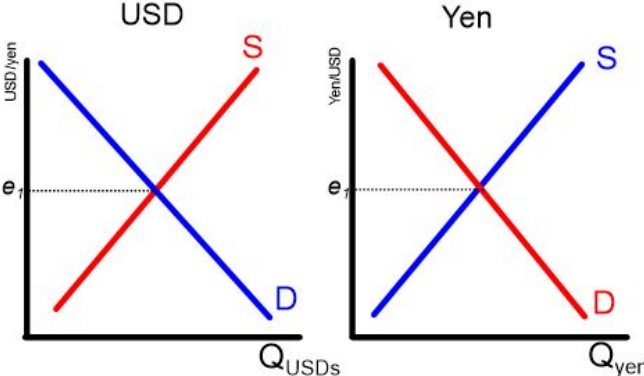
- Correct labels
- Key relationships
- Explanations
- Connections between loanable funds, interest rates, international monetary flows and trade

Review 1: Name that Label!

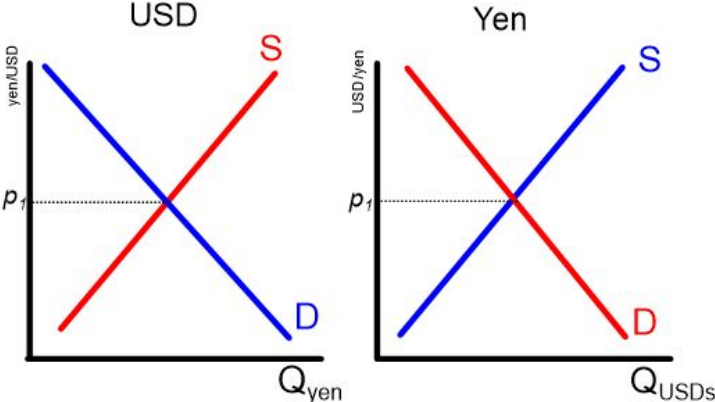


Review 2: Find the Mistake!

1)

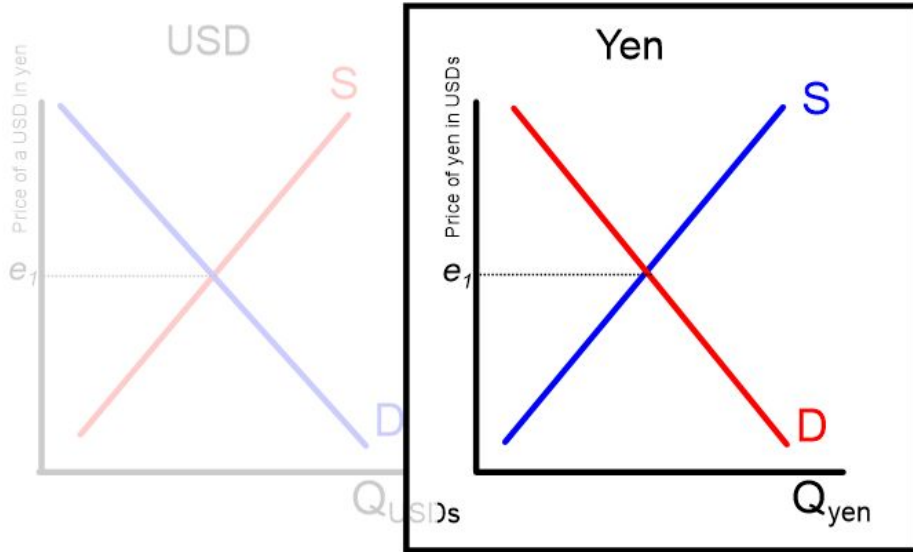


2)



Review 3: Practice Supply Shifts

What happens in the yen market when Japanese foreign direct investment in the US increases?



Key Relationships

Interest rates & Currency demand

$$RIR \uparrow \longrightarrow D_{\text{currency}} \uparrow$$

$$RIR \downarrow \longrightarrow D_{\text{currency}} \downarrow$$

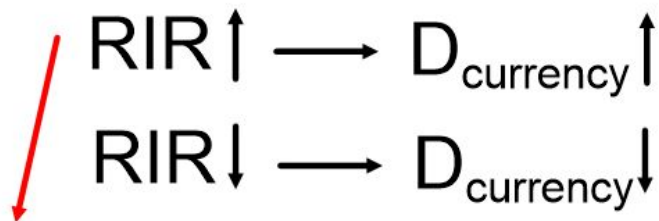
Currency value & Net exports

$$e_{\text{currency}} \uparrow \longrightarrow X_N \downarrow$$

$$e_{\text{currency}} \downarrow \longrightarrow X_N \uparrow$$

A second time, with explanation

Interest rates & Currency demand



When interest rates in the U.S. rise relative to other countries, there is increased foreign demand for U.S. financial assets.
(savers in other countries want their money in American banks)



A second time, with explanation

Currency value & Net exports

$$\begin{array}{l} \nearrow e_{\text{currency}} \uparrow \longrightarrow X_N \downarrow \\ \searrow e_{\text{currency}} \downarrow \longrightarrow X_N \uparrow \end{array}$$

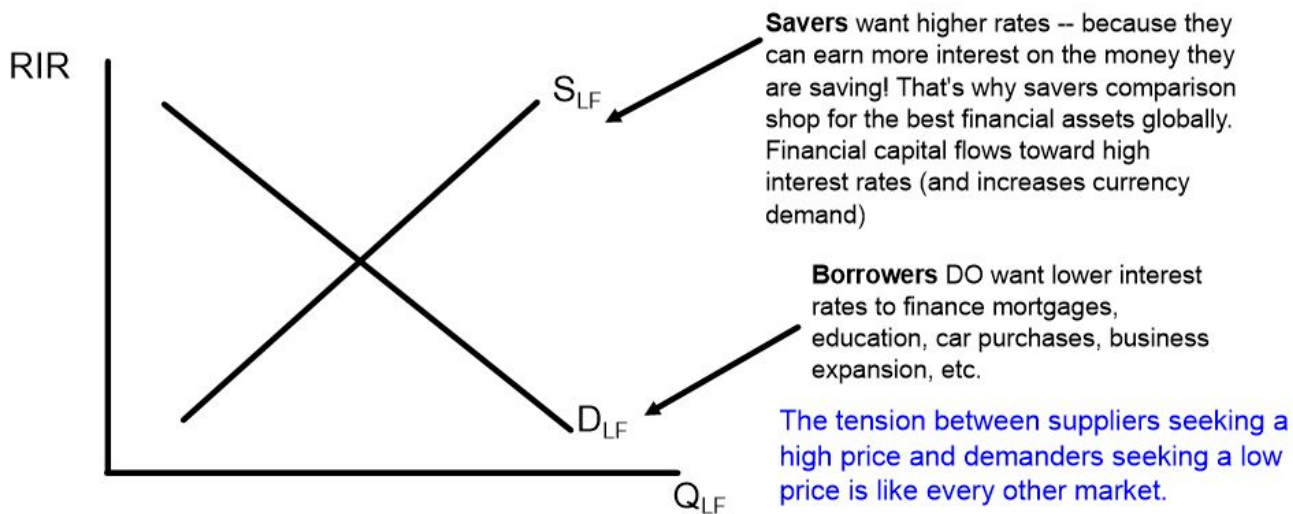
Currency appreciation makes foreign goods **relatively less expensive** (so imports rise) and makes domestic goods **relatively more expensive** to foreign purchasers (so exports fall).



Loanable Funds

Students often ask: Why is there greater demand for the USD when interest rates are higher? I thought people wanted *lower* interest rates.

Answer with the loanable funds market -- and international capital flows



Activity 7-5

CEE Workbook, pp. 235-240

p. 239

Foreign direct investment into the United States rose sharply during the second half of the 1990s due to the perceived strength and stability of the U.S economy relative to unstable economies worldwide. On a correctly labeled graph of the loanable funds market in the United States, illustrate the effect of this influx in FDI.



Activity 7-5

CEE Workbook, pp. 235-240

p. 239

Great Britain was a leading investor in American firms at this time. Using correctly labeled graphs of the markets for dollars and pounds to illustrate the relative change in value of these two currencies on the foreign exchange market as a result of British investment in American companies.



The changes above will cause U.S. net exports to (*increase/decrease*).

Let's Practice - AP FRQs

Q: Capital flow to Country X due to external turmoil

Country X has a flexible exchange rate and international capital mobility. Political turmoil outside of Country X generates capital flow into Country X.

- a) Using a correctly labeled foreign-exchange market graph, explain the impact of the capital inflow on the international value of the currency of Country X.
- b) For Country X, explain the effect of the change in the international value of its currency on each of the following.
 - i) Exports
 - ii) Imports

Let's Practice - AP FRQs

Q: Exchange between Songland and Europe, MP

Europe and Songland are trading partners with flexible exchange rates. Assume that yesterday the exchange rate between the euro and the Songland dollar was 1 euro = 0.58 Songland dollars. Assume that today the euro is trading at 1 euro = 0.60 Songland dollars.

(a) How will the change in the exchange rate affect each of the following in Songland in the short run?

i) Aggregate demand. Explain.

ii) The level of employment. Explain.

(b) Suppose that Songland wants to return the exchange rate to 1 euro = 0.58 Songland dollars.

(i) Should Songland's central bank buy or sell euros in the foreign exchange market?

(ii) Assume the banking system in Songland has limited reserves. Instead of buying or selling euros, what domestic open-market operation can Songland's central bank use to achieve the same result? Explain.

Let's Practice - AP FRQs

Q: Economy below FE - fiscal policy - RIR effects

Assume a country's economy is currently operating below full employment.

- (a) Identify a fiscal policy action the country's government could implement to restore full employment.
- (b) Draw a correctly labeled graph of the loanable funds market, and show the effect of the fiscal policy action identified in part (a) on the equilibrium real interest rate.
- (c) Based solely on the real interest rate change shown in part (b), what will happen to each of the following?
 - (i) Net exports. Explain.
 - (ii) The stock of physical capital. Explain.

Let's Practice - AP FRQs

Q: Effects of an inflow of funds to Canada

Due to an international financial crisis, Canada experiences a significant inflow of funds from other countries. Explain the effect that this inflow of funds will have on the following.

- (a) The international value of the Canadian dollar
- (b) Canadian net exports
- (c) The real interest rate in Canada
- (d) The level of investment in Canada

Let's Practice - AP FRQs

Q: Effects of budget deficit increase in Country A

Assume that an increase in government spending increases the budget deficit in Country A.

- (a) Using a correctly labeled graph of the loanable funds market, show the effect of the increase in Country A's budget deficit on the real interest rate.
- (b) Given your answer in (a), what is the effect on business investment in Country A?
- (c) The exchange rate between Country A's dollar and Country B's peso is determined in a flexible exchange market. Using a correctly labeled graph of the foreign exchange market for Country A's dollar, show how the interest rate change you identified in (a) affects the international value of Country A's dollar.
- (d) Given your answer to (c), explain how the competitiveness of Country A's goods changes relative to Country B's goods.

Let's Practice - AP FRQs

Q: Effects of investors moving funds out of Tara

Assume that as a result of increased political instability, investors move their funds out of the country of Tara.

- (a) How will this decision by investors affect the international value of Tara's currency on the foreign exchange market? Explain.
- (b) Using a correctly labeled graph of the loanable funds market in Tara, show the impact of this decision by investors on the real interest rate in Tara.
- (c) Given your answer in part (b), what will happen to Tara's rate of economic growth? Explain.

Your Questions?