This is an open book and open notebook exam. You cannot look at somebody else's books or notes. You can take the whole exam period, but you should not need it. This is worth 100 points towards the course grade. The point distribution is described below.

Suppose that you had complete control of both fiscal and monetary policy. The current unemployment rate is 3.9%. The current inflation rate is 2.0%. The current government has a small budget deficit and a large debt. The current nominal interest rate is 7.7%.

(25 points) What is the big problem in the economy described above: the unemployment rate, inflation rate, government deficit and debt, or the interest rate? Why do you think that? Explain why you do not think the others are "the big problem."

(25 points) What fiscal policy would be the best for fighting your big problem? Why would that be the best type of fiscal policy for that problem? Use SRAS/LRAS/AD, MS/MD, and the IS/LM/FE diagrams to illustrate the effects the policy you chose. Explain why the curve(s) moved as drawn.

(25 points) What type of monetary policy would be best for fighting the big problem? Why would that type of monetary policy be best for fighting the big problem? Use SRAS/LRAS/AD, MS/MD, and the IS/LM/FE diagrams to illustrate the effects described for the policy you chose. Explain why the curve(s) moved as drawn.

(25 points) Given your answers above, would you use fiscal policy, monetary policy, or a combination of the two? Explain your logic. How do the policies you described above affect unemployment, GDP, inflation, interest rates, and the government deficit? Use SRAS/LRAS/AD, MS/MD, and the IS/LM/FE diagrams to illustrate the effects described. Explain why your policies affect those variables in that manner. If you do not use a policy, explain why you chose not to use it. Remember, in the real world, solving one problem may worsen something else. If that occurs, explain why there is still a net benefit resulting from your policies, and how you may want to slightly change your policies, to improve the situation.