

Name: _____ Days/Times Class Meets: _____ Today's Date: _____

Macroeconomics, Spring 2009, Exam 3, several versions

Read these Instructions carefully! You must follow them exactly!

I) Answer on your Scantron card, using a #2 pencil.

Warning: SOME QUESTIONS MUST BE ANSWERED SEVERAL TIMES! Such questions will begin with a phrase such as this:

(Repeat answer on Scantron lines 37, 38 and 39)

---Remember to do it!

II) On your Scantron card you must print three things:

1) Print your full name clearly;

2) Print the day and time of your section (for example TTh 7 AM);

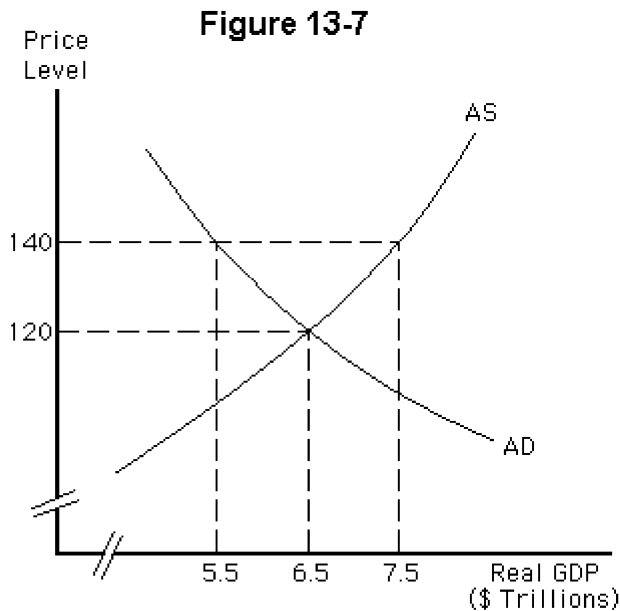
3) Near your name, print your test number from the upper right corner of this test.

(This number tells me which version of the test you have. Without it your test cannot be graded properly and you get no credit for your answers.)

III) You must turn in this printed exam along with your Scantron card, otherwise your score on this exam is "F".

Questions:

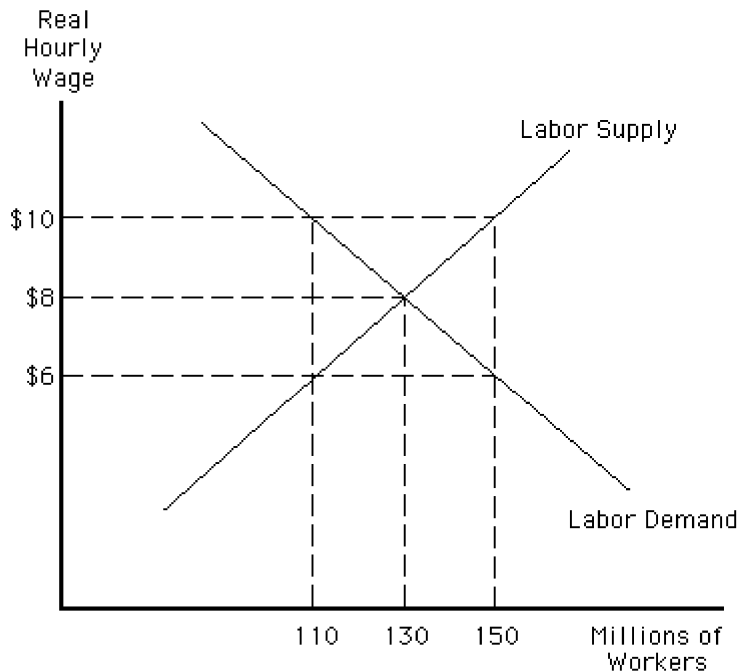
- _____ 1. **(Repeat your answer on Scantron line 29.)** A demand shock
- is any event that causes the aggregate demand curve to shift
 - is usually caused by a change in the price level
 - is usually caused by a change in real GDP
 - can be traced back to a shift in the economy's production possibilities frontier
 - is generally a good thing for the economy
- _____ 2. Which of the following would lead to a decrease in autonomous consumption spending?
- a decrease in disposable income
 - an increase in disposable income
 - an increase in the interest rate
 - more optimistic expectations about future income
 - an increase in wealth
- _____ 3. **(Repeat your answer on Scantron lines 30 and 31.)** Changes in government spending or taxes designed to stimulate the economy are examples of
- fiscal policy
 - monetary policy
 - supply management policy
 - classical policy
 - regulatory policy



- _____ 4. **(Repeat your answer on Scantron lines 32 and 33.)** Refer to **Figure 13-7**. If the economy is currently at a price level of 120 and real GDP is \$6.5 trillion, and you believe in the Keynesian model, an increase in government purchases will, in the short run,
- shift the aggregate demand curve rightward, increasing both the price level and real GDP
 - shift the aggregate demand curve leftward, decreasing both the price level and real GDP
 - shift the aggregate supply curve upward, increasing the price level and decreasing real GDP
 - shift the aggregate supply curve downward, decreasing the price level and increasing real GDP
 - have no effect on aggregate demand because of crowding out
- _____ 5. Real consumption spending is inversely related to
- real disposable income
 - the amount of common stock owned
 - the amount of real estate owned
 - expectations of future income
 - the interest rate
- _____ 6. In calculating total spending, after adding together Consumption, Investment, and Government Purchases, we must
- add imports and subtract exports
 - add exports and subtract imports
 - compute net consumption and net investment by subtracting products produced abroad
 - compute net consumption and net investment by adding products produced abroad
 - compute net consumption and net investment by add products consumed abroad

- _____ 7. According to the classical model, an increase in government purchases will
- lead to a change in the interest rate that encourages consumers to spend more
 - lead to a change in the interest rate that encourages private businesses to invest more
 - increase private spending by increasing the price level
 - be partially offset by a decline in consumption and investment spending, but still cause economic activity to increase.
 - leave total spending and output unchanged
- _____ 8. What major historical event led to the most significant challenge to classical economic thinking?
- the war on poverty
 - the American Revolution
 - World War II
 - the Great Depression
 - the oil shocks of the 1970s

Figure 7 - 1



- _____ 9. Refer to **Figure 7-1**. If the labor market is in equilibrium, there is no
- unemployment
 - frictional unemployment
 - structural unemployment
 - seasonal unemployment
 - cyclical unemployment

- _____ 10. **(Repeat your answer on Scantron line 34.)** Consider the following statements about inflation, expected inflation and interest rates.
- If actual inflation turns out lower than was expected at the time the loan was made, the lender loses and the borrower benefits.
 - if the expected inflation rate for the coming year rises from 3 percent to 6 percent, but the Fed prevents nominal interest rates from rising, then the real interest rate must have risen.
 - if the real interest rate is 10% for a 4 year auto loan, and expected inflation for the next four years is 5% per year, then auto loans will have a nominal interest rate of 15%.
 - the real interest rate plus the nominal interest rate equals the expected rate of inflation.
 - none of the other answers is correct.

Equation for the Money Supply

$$M_s = (C_T + T_f + L_f) \frac{\left(1 + \frac{1}{r_{cd}}\right)}{\left(1 + \frac{x_d}{r_{cd}} + \frac{x_t}{r_{ct}}\right)}$$

- _____ 11. **(Repeat your answer on Scantron line 35.)** Refer to the above equation for the money supply. Assume the following: 1) that changes in interest rates do not significantly alter the public's desired ratios of currency to demand deposits and currency to time deposits; 2) the Fed does not change any of the variables over which it exercises control; 3) the demand for money is inversely related to interest rates (interest rates up causes demand for money to fall). Then, an increase in government spending or a reduction in taxes
- will increase interest rates and have no impact on economic activity.
 - will increase economic activity because under these assumptions interest rates will not change and so the Keynesian model gives accurate predictions.
 - will result in both an increase in interest rates and also an increase in prices and/or economic activity (the latter because of an excess supply of money).
 - will reduce interest rates and have no impact on economic activity.
 - will actually reduce economic activity because the rise in interest rates will reduce borrowing and therefore spending.

- _____ 12. (**Repeat your answer on Scantron line 36.**) Suppose that just as the U.S. economy is heading into a recession, two major U.S. banks fail. Many citizens lose access to their checking accounts for several weeks. Also assume the Fed stupidly does nothing. Evaluate each of the following statements and select the best answer. (Refer to the money supply equation given just above if this helps you.)
- Reserve requirements on demand deposits and time deposits will increase because many citizens now will be afraid their bank might fail.
 - x_d and x_t in the equation will increase because many bankers now are afraid citizens will withdraw cash from the banks..
 - the public's desired ratios of currency to demand deposits, and currency to time deposits, will decline.
- all three statements are correct.
 - all three statements are false.
 - only statement 2 is correct.
 - only statement 3 is correct.
 - only statements 1 and 3 are correct.
- _____ 13. (**Repeat your answer on Scantron line 37.**) In the money supply equation just above, if the "money multiplier" is 1, then if the Fed buys \$5 billion of Treasury bonds and at the same time puts \$3 billion of new currency into circulation, then the money supply will:
- increase by \$2 billion.
 - decrease by \$2 billion.
 - increase by \$8 billion
 - decrease by \$8 billion.
 - neither increase nor decrease.
- _____ 14. (**Repeat your answer on Scantron line 38.**) Choose the **most complete** answer: An example of "derived demand" is,
- the demand curve you are able to derive from analysis of the impact of own price on the demand for a product.
 - the increased demand for oranges caused by a rise in the price of a substitute such as apples.
 - exactly two of the other answers are correct.
 - an increase in the demand for nails because of an increase in the demand for new houses.
 - an increase in the supply of dog food in response to an increase in the number of families who have dogs as pets.
- _____ 15. (**Repeat your answer on Scantron line 39.**) Assume that the Fed is successful in keeping the money supply constant, and suppose the economy is in an unemployment equilibrium. Earlier in the semester we "learned" that if government spending is increased, or taxes are cut, there will be no change in total economic activity, only interest rates will rise. But in that reasoning we left out an important fact, namely: when interest rates rise, this causes the demand for money to decline. Now my question to you is this: If you take that additional fact into account,
- a tax cut will increase economic activity, but an increase in government spending will not.
 - an increase in government spending will increase economic activity, but a tax cut will not.
 - an increase in government spending or a tax cut will create an excess supply of money and lead to an increase in economic activity.
 - an increase in government spending or a tax cut will reduce economic activity.
 - an increase in government spending or a tax cut will still leave total economic activity unchanged, since the supply of money is still being held constant.

Recall:

$$FR = IR * (FN/IN)*(PI/PF)$$

- _____ 16. (**Repeat your answer on Scantron lines 40 and 41.**) Between 1960 and 1983 the price index rises from 80 to 120. Over the same period your nominal wage rises from \$10/hour to \$12/ hour. Assume your real wage was \$20 in 1960. Then in 1983 your real wage becomes:
- \$16
 - \$11.11
 - \$36
 - \$20
 - \$24
- _____ 17. Which of the following is *not* included in the M1 money stock?
- small time deposits
 - demand deposits
 - checking account deposits
 - travelers' checks
 - cash in the hands of the public
- _____ 18. Financial intermediaries
- harm both borrowers and lenders because they pay lenders a lower rate of interest than they charge to borrowers
 - specialize in assembling loanable funds from households and firms, and channeling those funds to other households, firms, and government agencies
 - are all depository institutions
 - increase the risk of lending and borrowing because a financial intermediary has nothing to lose from such transactions
 - reduce efficiency because they add an extra step to many financial transactions
- _____ 19. The most powerful person at the Fed is
- a director of a Federal Reserve bank
 - a member of the Board of Governors
 - a district bank president
 - the president of the U.S.
 - the chairman of the Board of Governors
- _____ 20. (**Repeat your answer on Scantron line 42.**) The group within the Federal Reserve System that determines the general course for the nation's money supply is the
- Federal Monetary Oversight Committee
 - Federal Advisory Council
 - Board of Governors
 - Department of Commerce
 - Federal Open Market Committee
- _____ 21. Which of the following is an open market purchase?
- when private individuals sell government bonds
 - when the Fed sells government bonds
 - when private individuals purchase government bonds
 - when bond dealers buy government bonds from the fed
 - when the Fed buys government bonds

- _____ 22. **(Repeat your answer on Scantron lines 43 and 44.)** The Fed typically increases the money supply by
- selling government bonds
 - buying government loans
 - selling government loans
 - printing more currency
 - buying government bonds
- _____ 23. Which of the following would be most likely to increase the quantity of money demanded?
- an increase in the price level
 - a decrease in real income
 - an increase in the interest rate
 - a decrease in the cost of converting other assets into money
 - a decrease in the price level
- _____ 24. **(Repeat your answer on Scantron line 45.)** In the circular flow model as used in lecture, an open-market purchase of bonds by the Fed will
- raise the federal funds rate, reduce spending, and increase output
 - raise the federal funds rate, reduce spending, and decrease output
 - lower the federal funds rate, reduce spending, and decrease output
 - lower the federal funds rate, increase spending, and decrease output
 - lower the interest rate, increase spending, and increase output
- _____ 25. **(Repeat your answer on Scantron lines 46 and 47.)** When implementing monetary policy, the variable the Federal Reserve watches most closely is the
- required reserve ratio
 - federal funds rate
 - long term bond rate
 - national debt
 - short term corporate bond rate
- _____ 26. If the Fed wishes to maintain its interest rate target in the face of increased money demand it would likely
- increase the money supply.
 - decrease the money supply.
 - more stringently enforce already existing banking regulations.
 - propose new banking regulations.
 - become more lax when it enforces already existing banking regulations.

- _____ 27. **(Repeat your answer on Scantron lines 48 and 49.)** Think about an “experiment” in which the economy begins in a macroeconomic equilibrium, except that the money supply is growing for many years at the rate of 5% per year more than is needed, so prices have been rising at the rate of 5% per year. The economy is at full employment. The “real” interest rate, r , is about 4%. Now the experiment begins. Telling nobody, the Fed begins buying government securities more slowly than before, permanently reducing the rate of excessive money growth from 5% per year down to 2% per year. Evaluate the following statements, and then choose the best answer.
- 1) Even if it was not discussed in lecture, there is no reason to believe a recession will be caused by this experiment, since the money supply is still growing, just at a slower rate.
 - 2) Just before the experiment begins, nominal interest rates will be about 9%.
 - 3) After the experiment begins, there will probably be a long period of time during which lenders become better off while borrowers are becoming worse off.
- a. Only statements 1 and 2 are correct.
 - b. Only statements 2 and 3 are correct.
 - c. Only statements 3 and 1 are correct.
 - d. Only one of the statements are correct.
 - e. None of the statements are correct.
- _____ 28. **(Repeat your answer on Scantron line 50.)** In the long run, if the Fed lowers the inflation rate and holds it at that new rate,
- a. a zero inflation rate will be reached
 - b. a recession will not occur
 - c. inflationary expectations will fall
 - d. the natural rate of unemployment will rise
 - e. structural unemployment will start to decrease

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Answer Section

MULTIPLE CHOICE

1. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Aggregate demand and aggregate supply
2. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Aggregate demand and aggregate supply
3. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Understanding and applying economic models
4. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Aggregate demand and aggregate supply
5. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Aggregate demand and aggregate supply
6. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Aggregate demand and aggregate supply
7. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Understanding and applying economic models
8. ANS: D PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Understanding and applying economic models
9. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Understanding and applying economic models
10. ANS: C PTS: 1
11. ANS: C PTS: 1
12. ANS: C PTS: 1
13. ANS: C PTS: 1
14. ANS: D PTS: 1
15. ANS: C PTS: 1
16. ANS: A PTS: 1
17. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
18. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
19. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
20. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
21. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
22. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
23. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
24. ANS: E PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy

25. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
26. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
LOC: Monetary and fiscal policy
27. ANS: B PTS: 1
28. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
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