Economics 211		Macroeconomic Principles
Exam #2	**Time: 1h 15m**	Date: **9 – 11 April 2013**

Name _____   **Instructor: Brian B. Young**

The value of this exam is 100 points.   Please show your work where appropriate!

Multiple Choice

3 points each

#1

If the Fed wishes to contract the money supply, it could
   a.   decrease the interest rate paid on excess reserves.
   b.   purchase mortgage-backed securities from banks.
   c.   increase the interest rate paid on excess reserves.
   d.   decrease the required reserve ratio.

#2

 "Crowding out" occurs when investment declines because
        a. financing a budget deficit makes interest rates rise.
        b. financing a budget deficit makes interest rates fall.
        c. a budget surplus makes interest rates rise.
        d. a budget surplus makes interest rates fall.

#3

A balanced budget would require that when real GDP is contracting rapidly,
        a. the government raise taxes or cut expenditures. This would increase the magnitude of
        the business cycle.
        b. the government raise taxes or cut expenditures. This would decrease the magnitude of
        the business cycle.
        c. the government cut taxes or raise expenditures. This would increase the magnitude of
        the business cycle.
        d. the government cut taxes or raise expenditures. This would decrease the magnitude
        of the business cycle.

#4

The tendency for higher government budget deficits to decrease investment is called the
 a. Ricardo-Barro effect
 b. Wealth effect
 c. Bachman-Turner Overdrive effect.
 d. Crowding-out effect.

#5

When the world price of oil rises rapidly, it causes the
 a. AD curve to shift rightward.
 b. SRAS curve to shift leftward.
 c. SRAS curve to shift rightward.
 d. AD curve to shift leftward.

#6

The SRAS curve is upward sloping because
 a. supply curves are always convex.
 b. if nominal wages are held constant, real wages decline as the price level increases.
 c. nominal wages are "sticky," especially downwards.
 d. None of the above is correct.

#7

As output increases, the SRAS curve becomes increasingly steep because
 a. Supply curves are always convex.
 b. The SRAS curve reflects an economy with excess capacity in the region left of LRAS.
 c. Marginal units of real output become increasingly costly to the right of LRAS.
 d. Both b. and c. are correct.

#8
If the Fed buys a $100,000 government security from a bank when the required reserve ratio is 20 percent and the currency drain ratio is 5 percent, the bank can loan a maximum of
 a. $90,000.
 b. $100,000.
 c. $80,000.
 d. $75,000.

#9

For a government to add to the supply of loanable funds, it must
    a. Increase its demand for credit.
    b. Have a budget deficit.
    c. Raise the real interest rate.
    d. Have a budget surplus.

#10

New money is created in the U.S. economy by
    a.   Michael Bloomberg.
    b.   banks that create demand deposits.
    c.   new discoveries of gold.
    d.   U.S. Department of Mint.

#11

Antonio deposits $5,000 cash in his checking account at the Bank of America. If the required reserve ratio is 10 percent, Bank of America's
    a.   required reserves increase by $5,000.
    b.   assets do not change but its liabilities increase.
    c.   required reserves increase by $500 and its excess reserves increase by $4,500.
    d.   excess reserves increase by $5,000.

#12

If velocity does not change over time and the quantity of money grows at the same rate as does potential GDP, then in the long run
    a.   the inflation rate equals the growth rate of the quantity of money.
    b.   the nominal interest rate is less than the real interest rate.
    c.   the real interest rate is less than the nominal interest rate.
    d.   the inflation rate equals zero.

#13

During the 1990s, Canada had an average annual inflation rate of 1.5 percent while Columbia had an average annual inflation rate of 21.5 percent. You would expect that nominal interest rates in Canada are
    a.   less than nominal interest rates in Columbia.
    b.   equal to nominal interest rates in Columbia.
    c.   greater than nominal interest rates in Columbia.
    d.   unpredictably different from nominal interest rates in Columbia.

#14

Which of the following ingredients would one most likely find in the popular cocktail known as *Rum & Coke*?
    a. Maple syrup, Clamato juice, and refried beans.
    b. Rum, Coke, and, sometimes, a slice of lime.
    c. The aggregate demand curve shifts leftward until real output reaches zero.
    d. This question is an insult to my intelligence!

#15

The business cycle is defined as
    a.   changes in the stock market.
    b.   changes in financial markets.
    c.   persistent growth in potential GDP.
    d.   irregular ups and downs in output and employment.

#17

In a liquidity trap,
    a. fiscal stimulus is weak and conventional monetary policy is powerful.
    b. conventional monetary policy is weak and fiscal stimulus is powerful.
    c. government "crowding out" of private investment can become severe.
    d. inflationary expectations are high.

#18

The multiplier is 5 and, as a result of a change in expenditure, equilibrium expenditure and real GDP change by $200 billion. What was the initial change in autonomous expenditure?
   a. $1 trillion
   b. $40 billion
   c. $50 billion
   d. $20 billion

#19

When a bank decides to purchase government securities, its
   a.   excess reserves decrease and its liabilities do not change.
   b.   liabilities increase and its assets increase.
   c.   liabilities decrease and its assets increase.
   d.   excess reserves increase and its assets decrease.

#20

The AD curve is downward sloping primarily because
   a.   demand curves are always downward sloping.
   b.   as the price level increases, the buying power of money decreases.
   c.   nominal wages are "sticky," especially downwards.
   d.   none of the above is correct.

Short Answer

10 points each

#1

Define "stagflation" and explain how it can be created. Use the AS-AD model to graphically depict stagflation. Has the U.S. ever experienced a period of stagflation?

#2

Explain (compare and contrast) how the tactics and strategies of the Federal Reserve differ from the period prior to 2008 to the period after 2008. For example, comment on types of securities used in OMO before and after, size of balance sheet before and after, new tactics employed since 2008 and how conventional tactics have changed, etc. and so forth and so on… and, there you go… as it were.

#3

What is the "crowding out" effect and how does it operate? What is its relationship to the liquidity trap?

#4

You are given information about an economy that, at equilibrium expenditures, the following table applies

State:	1	2	3
Price level:	157.5	153.75	151.5
Real output:	$850 billion	$900 billion	$950 billion

Further, assume that the slope of the *AE* curves is 0.5.   Graphically depict this situation in the *Aggregate Expenditure* model and, then, derive three points on the *AD* curve. Also, please label both the axes and all three of your *AE* curves for full credit.

Aggregate Expenditure

Aggregate Demand

45°