

INTRODUCTION TO MACROECONOMICS (ECO 1102)

Practice Exam #3

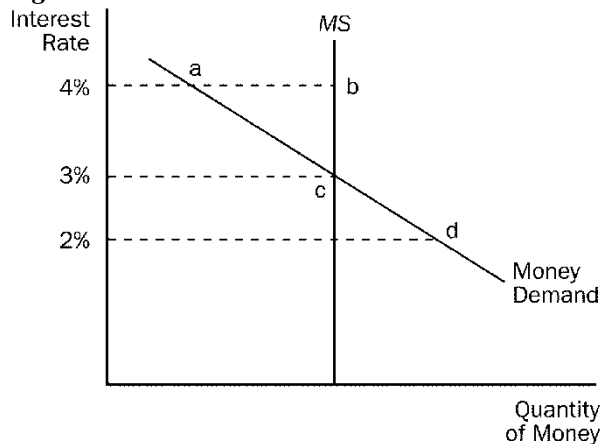
Coverage: Mankiw chapters 15, 16 and 17

1. Which of the following claims concerning the importance of effects that explain the slope of the aggregate demand curve in Canada is correct?
 - a. The exchange-rate effect is relatively small because exports and imports are a small part of real GDP.
 - b. The interest-rate effect is relatively small because investment spending is not very responsive to interest rate changes.
 - c. The wealth effect is relatively large because money holdings are a significant portion of most households' wealth.
 - d. None of the above is correct.
2. Liquidity preference theory is most relevant to the
 - a. short run and supposes that the price level adjusts to bring money supply and money demand into balance.
 - b. short run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
 - c. long run and supposes that the price level adjusts to bring money supply and money demand into balance.
 - d. long run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
3. If expected inflation is constant, then when the nominal interest rate increases, the real interest rate
 - a. increases by more than the change in the nominal interest rate.
 - b. increases by the change in the nominal interest rate.
 - c. decreases by the change in the nominal interest rate.
 - d. decreases by more than the change in the nominal interest rate.
 - e. It is impossible to predict what will happen to the real interest rate.
4. According to liquidity preference theory, the money supply curve is

- a. upward sloping.
 - b. downward sloping.
 - c. vertical.
 - d. horizontal.
 - e. A rectangular hyperbola.
5. According to liquidity preference theory, the money supply curve would shift if Bank of Canada
 - a. engaged in open-market transactions.
 - b. changed the bank rate.
 - c. changed the reserve requirement.
 - d. did any of the above.
 6. The opportunity cost of holding money
 - a. decreases when the interest rate increases, so people desire to hold more of it.
 - b. decreases when the interest rate increases, so people desire to hold less of it.
 - c. increases when the interest rate increases, so people desire to hold more of it.
 - d. increases when the interest rate increases, so people desire to hold less of it.

For the following questions, consult the diagram below:

Figure 34-1



7. **Refer to Figure 34-1.** If the current interest rate is 2 percent,
 - a. there is excess money supply.
 - b. people will sell more bonds, which drives interest rates up.
 - c. as the money market moves to equilibrium, people will buy more goods.
 - d. All of the above are correct.
8. **Refer to Figure 34-1.** There is excess money demand at an interest rate of
 - a. 2 percent.
 - b. 3 percent.
 - c. 4 percent.
 - d. None of the above are correct.
9. **Refer to Figure 34-1.** At an interest rate of 4 percent there is excess
 - a. money demand equal to the distance between a and b.
 - b. money demand equal to the distance between b and c.
 - c. money supply equal to the distance between b and a.
 - d. money supply equal to the distance between c and b.

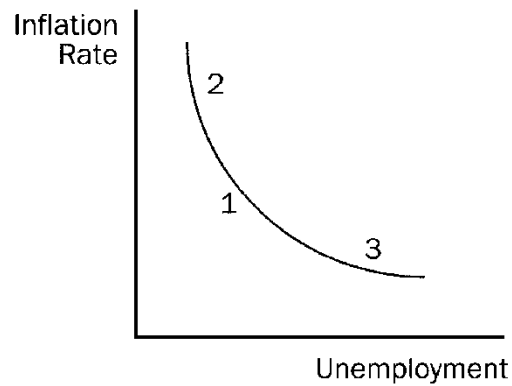
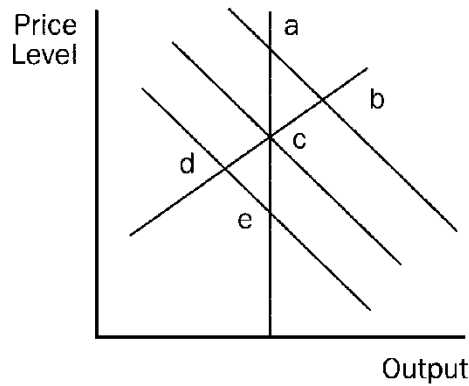
10. According to liquidity preference theory, if the quantity of money supplied is greater than the quantity demanded the interest rate will
 - a. increase and the quantity of money demanded will decrease.
 - b. increase and the quantity of money demanded will increase.
 - c. decrease and the quantity of money demanded will decrease.
 - d. decrease and the quantity of money demanded will increase.
11. People will want to hold more money if the price level
 - a. or the interest rate increases.
 - b. or the interest rate decreases.
 - c. increases or the interest rate decreases.
 - d. decreases or the interest rate increases.
12. Which of the following is correct?
 - a. Both liquidity preference and classical theory assume the interest rate adjusts to bring the money market into equilibrium.
 - b. Both liquidity preference and classical theory assume the price level adjusts to bring the money market into equilibrium.
 - c. Liquidity preference theory assumes the interest rate adjusts to bring the money market into equilibrium. Classical theory assumes the price level adjusts to bring the money market into equilibrium.
 - d. Liquidity preference theory assumes the price level adjusts to bring the money market into equilibrium. Classical theory assumes the interest rate adjusts to bring the money market into equilibrium.
13. Which of the following statements is true?
 - a. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for money; and the price level adjusts to balance the supply and demand for loanable funds.
 - b. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.
 - c. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level is stuck.
 - d. In the long run, output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.
14. Which of the following shifts money demand to the right?
 - a. an increase in the price level
 - b. A decrease in the price level
 - c. an increase in the interest rate
 - d. A decrease in the interest rate
15. There is a
 - a. short-run tradeoff between inflation and unemployment.
 - b. short-run tradeoff between the actual unemployment rate and the natural rate of unemployment.
 - c. long-run tradeoff between inflation and unemployment.
 - d. long-run tradeoff between the actual unemployment rate and the natural rate of

unemployment.

16. If policymakers expand aggregate demand,
 - a. In the long run, prices will be higher and unemployment will be lower.
 - b. In the long run, prices will be higher and unemployment will be unchanged.
 - c. In the long run, inflation and unemployment will be unchanged.
 - d. None of the above is correct.
17. The short-run relationship between inflation and unemployment is often called
 - a. the Classical Dichotomy.
 - b. Money Neutrality.
 - c. the Phillips curve.
 - d. the Keynesian cross.
 - e. the Solow/Samuelson curve.
18. If the short-run Phillips curve were stable, which of the following would be unusual?
 - a. an increase in government spending and a fall in unemployment
 - b. an increase in inflation and a decrease in output
 - c. A decrease in the inflation rate and a rise in the unemployment rate
 - d. A decrease in output and an increase in unemployment
19. When aggregate demand increases, prices
 - a. will fall and unemployment will rise.
 - b. and unemployment fall.
 - c. and unemployment rise.
 - d. will rise and unemployment will fall.
20. Suppose that the money supply increases. In the short run, this increases employment according to
 - a. both the short-run Phillips curve and the aggregate demand and aggregate supply model.
 - b. neither the short-run Phillips curve nor the aggregate demand and aggregate supply model.
 - c. only the short-run Phillips curve.
 - d. only the aggregate demand and aggregate supply model.
21. Which of the following would we not expect if government policy moved the economy up along a given short-run Phillips curve?
 - a. Ravi reads in the newspaper that the central bank raised the money supply.
 - b. Tony gets more job offers.
 - c. Louis makes smaller increases in the prices at his health food store.
 - d. Jessica's nominal wage increases at a faster rate.
 - e. None of the above are correct.

Use the pair of diagrams below to answer the following questions.

Figure 35-1



22. **Refer to Figure 35-1.** If the economy starts at c and 1, then in the short run, an increase in the money supply growth rate moves the economy to
- A and 1.
 - B and 2.
 - C and 3.
 - None of the above is correct.
23. **Refer to Figure 35-1.** If the economy starts at c and 1, then in the short run, an increase in government expenditures moves the economy to
- B and 2.
 - B and 3.
 - D and 3.
 - None of the above is correct.
24. **Refer to Figure 35-1.** If the economy starts at c and 1, then in the short run, a decrease in taxes moves the economy to
- D and 2.
 - D and 3.
 - back to c and 1.
 - None of the above is correct.
25. Opponents of using policy to stabilize the economy generally believe that
- neither fiscal nor monetary policy have much impact on aggregate demand.
 - attempts to stabilize the economy can increase the magnitude of economic fluctuations.
 - unemployment and inflation are not cause for much concern.
 - All of the above are correct.
26. The economy goes into recession. Which of the following lists contains things policymakers could do to try to end the recession?
- increase the money supply, increase taxes, increase government spending
 - increase the money supply, increase taxes, decrease government spending
 - increase the money supply, decrease taxes, increase government spending
 - decrease the money supply, increase taxes, decrease government spending
27. Which of the following is *not* an argument in *favour* of policymakers trying to stabilize the economy?
- Recessions represent a waste of resources.
 - Pessimism on the part of households and firms may become a self-fulfilling prophecy.
 - "Leaning against the wind" requires policymakers to increase aggregate demand in recessions and reduce aggregate demand in booms.
 - Macroeconomic theory is not developed sufficiently to show policymakers how to change

aggregate demand.

28. Suppose that the central bank must follow a rule that requires it to increase the money supply when the price level falls and decrease the money supply when the price level rises. If the economy starts from long-run equilibrium and aggregate supply shifts left, the central bank must
 - a. decrease the money supply, which will move output back towards its long-run level.
 - b. decrease the money supply, which will move output farther from its long-run level.
 - c. increase the money supply, which will move output back towards its long-run level.
 - d. increase the money supply, which will move output farther from its long-run level.
29. Which of the following is *not* an argument *against* requiring monetary policy to be made by rule rather than by discretion?
 - a. The economy is subject to a variety of random shocks.
 - b. Monetary policymakers are **not** allowed undisciplined discretion.
 - c. Historically, it is not clear how important political business cycles have been.
 - d. Central banks can achieve credibility over time by backing up their words with deeds.
 - e. None of the above is correct.
30. Proponents of zero inflation argue that a successful program to reduce inflation
 - a. eventually reduces inflation expectations.
 - b. eventually raises real interest rates.
 - c. permanently decreases output.
 - d. permanently raises unemployment.
31. A program to reduce inflation is likely to have higher costs if the sacrifice ratio is
 - a. high, and the reduction is unexpected.
 - b. high, and the reduction is expected.
 - c. low, and the reduction is unexpected.
 - d. low, and the reduction is expected.
32. If the Canadian government went from a budget deficit to a budget surplus, we would expect a(n)
 - a. increase in interest rates and investment.
 - b. increase in interest rates and a decrease in investment.
 - c. decrease in interest rates and a decrease in investment.
 - d. decrease in interest rates and an increase in investment.
33. Which of the following is true?
 - a. Deficits require people to consume at the expense of their children.
 - b. If the government uses funds to pay for useful programs, on net the debt need not burden future generations.
 - c. If the government runs a deficit, it is necessarily in debt.
 - d. The current government debt is about \$114,000 per person.
 - e. Both a and c are correct.
34. Which of the following is *not* an argument *against* requiring the government to balance its budget?
 - a. Some economists believe that rules are better than discretion.
 - b. Per-capita debt is small relative to lifetime income.
 - c. The effect of deficit spending on future generations depends in part on what the government buys.
 - d. Other government policies also redistribute income across generations.
35. Double taxation means that both
 - a. wage income and interest income are taxed, which is currently the case in Canada.

- b. wage income and interest income are taxed, which is not currently the case in Canada.
- c. the profits of corporations and the dividends shareholders receive are taxed, which is not currently the case in Canada.
- d. the profits of corporations and the dividends shareholders receive are taxed, which is currently the case in Canada.
- e. Both a and d are correct.

<u>Question Number</u>	<u>Answer</u>	<u>Question Number</u>	<u>Answer</u>
1	D	31	A
2	B	32	D
3	B	33	B
4	C	34	A
5	D	35	D
6	D	36	
7	B	37	
8	A	38	
9	C	39	
10	D	40	
11	C	41	
12	C	42	
13	B	43	
14	A	44	
15	A	45	
16	B	46	
17	C	47	
18	B	48	
19	D	49	
20	A	50	
21	C	51	
22	B	52	
23	A	53	
24	D	54	
25	B	55	
26	C	56	
27	D	57	
28	D	58	
29	B	59	
30	A	60	