

# SOS ECON102 FINALS REVIEW PACKAGE

**Remember, this package only offers a short review of the material that will covered on the midterm. It is most effective when used in conjunction with your textbook, study guide, and the PowerPoint provided.**

## CH11: MONEY GROWTH AND INFLATION

### Terms

#### **Classical dichotomy**

- the theoretical separation of nominal and real variables

#### **Fisher effect**

- the one-for-one adjustment of the nominal interest rate to the inflation rate

#### **Inflation tax**

- the revenue the government raises by creating money

#### **Menu costs**

- the costs of changing prices

#### **Monetary neutrality**

- the proposition that changes in the money supply do not affect real variables

#### **Nominal variables**

- variables measured in monetary units

#### **Quantity equation**

- the equation  $M3V5P3Y$ , which relates the quantity of money, the velocity of money, and the dollar value of the economy's output of goods and services

#### **Quantity theory of money**

- a theory asserting that the quantity of money available determines the price level and that the growth rate in the quantity of money available determines the inflation rate

#### **Real variables**

- variables measured in physical units

#### **Shoelather costs**

- the resources wasted when inflation encourages people to reduce their money holdings

#### **Velocity of money**

- the rate at which money changes hands

### Multiple Choice

1. If the money supply is increased, then in the long run the price level
  - a. and the quantity of money demanded increase.
  - b. increases, but the quantity of money demanded decrease.
  - c. decreases, but the quantity of money demanded increases.
  - d. and the quantity of money demanded decreases.
2. According to the principle of monetary neutrality, an increase in the money supply, *ceteris paribus*, will
  - a. increase real GDP and the price level.
  - b. increase real GDP, but not the price level.
  - c. increase the price level, but not real GDP.
  - d. increase neither the price level nor real GDP.
3. When a government prints money to finance its expenditures, this
  - a. increases the value of money.
  - b. imposes an "inflation tax" on everyone who holds money.
  - c. is the principle method by which the Canadian government finances its expenditures.
  - d. All of the above are correct.
4. Inflation is directly proportional to
  - a. nominal wage growth and nominal interest rates.
  - b. neither nominal wage growth nor nominal interest rates.
  - c. nominal wage growth, but not nominal interest rates.
  - d. the nominal interest rate, but not nominal wage growth.
5. Wealth is distributed from borrowers to lenders when inflation is

- a. high, but expected.
  - b. low, but expected.
  - c. unexpectedly high.
  - d. unexpectedly low.
6. If the nominal interest rate is 8 percent and the inflation rate is 3 percent the real interest rate is
- a. -5 percent
  - b. 3 percent
  - c. 5 percent
  - d. 11 percent
7. A change in a price level indicates
- a. that the economy has experienced deflation
  - b. the existence of inflation
  - c. a decline in real GDP
  - d. that either inflation or deflation may exist
8. If the supply of money increases
- a. the price level falls
  - b. real output falls
  - c. expenditures (PY) increase
  - d. velocity increases
9. The revenue the government raises by creating money is known as
- a. regressive taxation
  - b. the deadweight loss of taxation
  - c. the neutrality of taxation
  - d. an inflation tax
10. When the money supply increases
- a. the value of money increases
  - b. the demand for money increases
  - c. the value of money decreases
  - d. the demand for money decreases
11. The primary result of inflation is
- a. a decline in prices
  - b. a rise in wages
  - c. a decline in the value of money
  - d. a rise in personal wealth
12. The theoretical separation of nominal and real variables is known as
- a. Engel's law
  - b. the classical dichotomy
  - c. Gresham's law
  - d. Newton's law
13. The relationship of the money demand curve to the value of money is shown by its
- a. downward slope
  - b. upward slope
  - c. horizontal position
  - d. vertical position
14. What determines the quantity of money individuals and businesses want to hold?
- a. how much they rely on credit
  - b. the quantity theory of money

- c. the resources available in the economy
  - d. The Bank of Canada sets the amount of money individuals hold.
15. The primary effect of an increase in the money supply would be:
- a. an increase in real GDP
  - b. a reduction in velocity
  - c. a decrease in the unemployment rate
  - d. a proportional increase in prices

**Answers:**

- 1. A
- 2. C
- 3. B
- 4. A
- 5. D
- 6. C
- 7. D
- 8. C
- 9. D
- 10. C
- 11. C
- 12. B
- 13. A
- 14. A
- 15. D

*CH12: OPEN-ECONOMY MACROECONOMICS: BASIC CONCEPTS*

**Terms**

**Appreciation**

- an increase in the value of a currency as measured by the amount of foreign currency it can buy

**Balanced trade**

- a situation in which exports equal imports

**Closed economy**

- an economy that does not interact with other economies in the world

**Depreciation**

- a decrease in the value of a currency as measured by the amount of foreign currency it can buy

**Exports**

- goods and services that are produced domestically and sold abroad

**Imports**

- goods and services that are produced abroad and sold domestically

**Interest rate parity**

- a theory of interest rate determination whereby the real interest rate on comparable financial assets should be the same in all economies with full access to world financial markets

**Net capital outflow**

- the purchase of foreign assets by domestic residents minus the purchase of domestic assets by foreigners

**Net exports**

- the value of a nation's exports minus the value of its imports; also called the trade balance

**Nominal exchange rate**

- the rate at which a person can trade the currency of one country for the currency of another

**Open economy**

- an economy that interacts freely with other economies around the world

**Perfect capital mobility**

- full access to world financial markets

**Purchasing-power parity**

- a theory of exchange rates whereby a unit of any given currency should be able to buy the same quantity of goods in all countries

**Real exchange rate**

- the rate at which a person can trade the goods and services of one country for the goods and services of another

**Small open economy**

- an economy that trades goods and services with other economies and by itself, has a negligible effect on world prices and interest rates

**Trade balance**

- the value of a nation's exports minus the value of its imports; also called net exports

**Trade deficit**

- an excess of imports over exports

**Trade surplus**

- an excess of exports over imports

**Multiple Choice**

1. The increase in international trade in Canada in the past decade is partly due to
  - a. improvements in transportation.
  - b. advances in telecommunications.
  - c. negotiated removal of trade barriers.
  - d. All of the above are correct.
2. When Canada sells Blackberrys to the United States, U.S. net exports
  - a. increase, and U.S. net capital outflow increases.
  - b. increase, and U.S. net capital outflow decreases.
  - c. decrease, and U.S. net capital outflow increases.
  - d. decrease, and U.S. net capital outflow decreases.
3. If a country has \$50 million of net exports and \$70 million of saving, net capital outflow must be
  - a. \$50 million and domestic investment is \$70 million.
  - b. \$120 million and domestic investment is \$70 million.
  - c. \$50 million and domestic investment is \$20 million.
  - d. None of the above is correct.
4. All saving in the Canadian economy shows up as
  - a. investment in the Canadian economy.
  - b. Canadian net capital outflow.
  - c. either investment in the Canadian economy or Canadian net capital outflow.
  - d. None of the above is correct.
5. If the exchange rate changes from 180 yen per dollar to 120 yen per dollar, the dollar has
  - a. appreciated and so buys more Japanese goods.
  - b. appreciated and so buys fewer Japanese goods.
  - c. depreciated and so buys more Japanese goods.
  - d. depreciated and so buys fewer Japanese goods.
6. The nominal exchange rate is the price of
  - a. foreign goods in a country
  - b. a country's exports in the foreign country
  - c. one currency in terms of another currency
  - d. one good in terms of another good
7. When a currency appreciates, the

- a. prices in that country are falling
  - b. prices in that country are rising
  - c. currency buys fewer units of another currency
  - d. currency buys more units of another currency
8. A trade deficit is
- a. an excess of government spending over tax collections
  - b. an excess of exports over imports
  - c. an excess of imports over exports
  - d. an excess of supply over demand
9. Which of the following best characterizes an open economy?
- a. It is a developed nation that is growing.
  - b. It effectively prevents imports.
  - c. Its population is growing rapidly due to immigration.
  - d. It interacts freely with other economies around the world.
10. Suppose that a German-produced car becomes very popular in Canada. This would tend to
- a. affect Canadian net exports but not the trade balance
  - b. reduce any existing balance of trade deficit in Canada
  - c. increase a trade surplus in Canada
  - d. increase a trade deficit in Canada
11. Which of the following are limitations of the purchasing power parity theory?
- a. Goods are generally homogenous in nature.
  - b. Many goods are not traded.
  - c. Relative changes in price levels tend to be identical across industrial nations.
  - d. All goods are traded at some point in time.
12. The rate at which one country's currency can be traded for another's is called
- a. the interest rate
  - b. the inflation rate
  - c. special drawing rights
  - d. the nominal exchange rate
13. If one Japanese yen equals \$.0094, how many yen can be purchased with \$1.00?
- a. 94.00
  - b. 106.38
  - c. 9.4
  - d. 10.63
14. Suppose we have a hypothetical two-country world, Canada and Japan. Also suppose that fish is the only product for export between the two countries, and that fish is homogeneous. Assume the price for fish in Canada is \$4.00 per pound and is 500 yen per pound in Japan. What is the real exchange rate between Canada and Japan?
- a. \$1 = 500 yen
  - b. \$1 = 125 yen
  - c. \$1 = 100 yen
  - d. \$1 = 50 yen
15. The acquisition of foreign assets by domestic residents minus the acquisition of domestic assets by foreigners is called
- a. the balance of trade
  - b. net foreign investment
  - c. the real exchange rate

- d. a way of securing higher terms of trade

## **Answers**

1. D
2. D
3. C
4. C
5. D
6. C
7. D
8. C
9. D
10. D
11. B
12. D
13. B
14. B
15. B

## ***CH14: AGGREGATE DEMAND AND AGGREGATE SUPPLY***

### **Terms**

#### **Aggregate-demand curve**

- a curve that shows the quantity of goods and services that households, firms, and the government want to buy at each price level

#### **Aggregate-supply curve**

- a curve that shows the quantity of goods and services that firms choose to produce sell at each price level

#### **Depression**

- a severe recession

#### **Model of aggregate demand and aggregate supply**

- the model that most economists use to explain short-run fluctuations in economic activity around its long-run trend

#### **Recession**

- a period of declining real incomes and rising unemployment

#### **Stagflation**

- a period of falling output and rising prices

### **Multiple Choice**

1. In recent years, the decrease in real GDP during a recession is
  - a. mostly a decrease in investment spending.
  - b. mostly a decrease in consumption spending.
  - c. mostly a decrease in net exports.
  - d. None of the above.
  
2. Economists generally agree that classical economic theory applies
  - a. in neither the short nor long run.
  - b. in the short run and in the long run.
  - c. in the short run, but not in the long run.
  - d. in the long run, but not in the short run.
  
3. To increase aggregate demand, a government could
  - a. raises personal income taxes.
  - b. decrease the money supply.
  - c. begin a new tax credit for business investment.

d. All of the above are correct.

4. A recession caused by a reduction in aggregate demand corrects itself over time as the expected price level rises, shifting aggregate demand right.
- rises, shifting aggregate demand left.
  - falls, shifting aggregate supply right.
  - falls, shifting aggregate supply left.

5. Changes in the price of oil
- can only lead to recessions.
  - have had little effect on the business cycle in Canada.
  - change the economy principally by changing aggregate demand.
  - created both inflation and recession in Canada in the 1970s.

6. If oil prices fall
- aggregate demand shifts left, the price level falls, and real output falls
  - aggregate demand shifts right, the price level rises, and real output rises
  - aggregate supply shifts right, the price level falls, and real output rises
  - aggregate supply shifts left, the price level rises, and real output falls

7. Which of the following will occur during a recession?
- increases in unemployment
  - decreases in real output
  - decreases in real income
  - all of the above

8. An improvement in technology would shift which of the following curves?
- only the aggregate demand curve
  - the aggregate demand curve and the short-run aggregate supply curve
  - only the short-run aggregate supply curve
  - the short-run and long-run aggregate supply curves

9. Which of the following is most likely to cause a decrease in aggregate supply?
- a decline in the productivity of labour
  - a decrease in resource prices
  - an increase in capital formation
  - an increase in the price level

10. Which of the following will lead to a reduction in aggregate demand in Canada?
- a higher price level
  - rapid growth of real income in Japan and Western Europe
  - an increase in consumer confidence
  - an increase in real interest rates

11. The increase in the wealth of households and businesses resulting from the increased purchasing power of a constant supply of money as the price level declines is referred to as:
- the wealth effect.
  - the inflationary tradeoff.
  - the nominal income effect.
  - the multiplier.

12. The aggregate demand for goods and services is composed of the purchases of:
- households and businesses
  - governments and net exports.
  - households, governments, and net exports.
  - households, businesses, governments, and net exports.

13. Starting with initial long-run equilibrium, a sudden decrease in optimism about future business conditions will cause (in the short run)
- an increase in output and a reduction in the price level
  - an increase in both output and the price level
  - a reduction in both output and the price level
  - a reduction in output and an increase in the price level
14. Which of the following basic economic concepts most clearly provides the foundation for the long-run aggregate supply curve?
- the law of demand
  - the classical dichotomy and monetary neutrality
  - the law of increasing marginal returns
  - the law of diminishing marginal utility
15. A decrease in the price level will
- decrease the quantity of goods and services demanded
  - lead to a reduction in net exports to foreigners
  - decrease the wealth of persons holding the fixed supply of money
  - increase the value of the money that is in circulation

### **Answers**

- A
- D
- C
- C
- D
- C
- D
- D
- A
- D
- A
- D
- C
- B
- D

## ***CH15: THE INFLUENCE OF MONETARY AND FISCAL POLICY ON AGGREGATE DEMAND***

### **Terms**

#### **Automatic stabilizers**

- changes in fiscal policy that stimulate aggregate demand when the economy goes into a recession, without policymakers having to take any deliberate action"

#### **Crowding-out effect on investment**

- the offset in aggregate demand that results when expansionary fiscal policy raises the interest rate and thereby reduces investment spending

#### **Crowding-out effect on net exports**

- the offset in aggregate demand that results when expansionary fiscal policy in a small open economy with a flexible exchange rate raises the real exchange rate and thereby reduces net exports

#### **Multiplier effect**

- the additional shifts in aggregate demand that result when expansionary fiscal policy increases income and thereby increases consumer spending

#### **Theory of liquidity preference**

- Keynes's theory that the interest rate adjusts to bring money supply and money demand into balance

### **Multiple Choice**

1. Most economists believe that fiscal policy affects
  - a. only aggregate demand and not aggregate supply.
  - b. aggregate demand much more than aggregate supply.
  - c. aggregate supply more than aggregate demand.
  - d. only aggregate supply and not aggregate demand.
2. When Bank of Canada sets a target for the interest rate, it commits itself to
  - a. revealing its target to the public.
  - b. adjusting the demand for money in order to meet the interest rate target.
  - c. adjusting the money supply in order to meet the interest rate target.
  - d. All of the above.
3. When Bank of Canada decreases the rate of growth of the money supply, we expect
  - a. interest rates and stock prices to both rise.
  - b. interest rates and stock prices to both fall.
  - c. interest rates to rise and stock prices to fall.
  - d. interest rates to fall and stock prices to rise.
4. According to the crowding-out effect, an increase in government spending leads to
  - a. increased interest rates and greater investment spending.
  - b. increased interest rates and reduced investment spending.
  - c. decreased interest rates and greater investment spending.
  - d. decreased interest rates and reduced investment spending.
5. When interest rates rise in Canada, the opportunity cost of holding money
  - a. increases, so the quantity of money demanded increases.
  - b. increases, so the quantity of money demanded decreases.
  - c. decreases, so the quantity of money demanded increases.
  - d. decreases, so the quantity of money demanded decreases.
6. Which of the following serves as an automatic stabilizer?
  - a. the Bank of Canada
  - b. the income tax system
  - c. the crowding-in effect
  - d. autonomous consumption
7. Fiscal policy would include
  - a. lowering taxes
  - b. raising taxes
  - c. changes in government spending
  - d. all of the above
8. The main reason for holding money balances is
  - a. it is a form of interest-free wealth
  - b. it can be used to buy things
  - c. it appreciates over time
  - d. all of the above
9. One problem with fiscal policy is that
  - a. policymakers do not have accurate information about the economy in advance
  - b. policymakers have perfect information about the economy in advance
  - c. it is less powerful than monetary policy

- d. policymakers can use it to respond immediately to changes in economic conditions
10. When the price level increases, the money demand curve shifts to the
- right, causing interest rates to fall
  - right, causing interest rates to rise
  - left, causing interest rates to rise
  - left, causing interest rates to fall
11. Other things being equal, an increase in the supply of money
- lowers both interest rates and aggregate demand
  - raises both interest rates and aggregate demand
  - raises interest rates and lowers aggregate demand
  - lowers interest rates and raises aggregate demand
12. In the short run, an open market sale of government bonds by the Bank of Canada will cause
- the money supply curve to shift to the right
  - the money supply curve to shift to the left
  - the rate of interest to fall
  - the government to pursue a fiscal policy designed to decrease aggregate demand
13. Other things being equal, an increase in the demand for money
- increases aggregate quantity demand
  - decreases aggregate quantity demand
  - increases aggregate quantity supply
  - decreases aggregate quantity supply
14. Taking the multiplier effect into account, a \$100 million increase in government spending will
- increase real output by less than \$100
  - decrease real output by less than \$100
  - increase real output by more than \$100
  - decrease real output by more than \$100
15. The opportunity cost of holding assets in the form of money is
- foregone liquidity
  - foregone interest
  - the unacceptability of money
  - that money is not a good store of nominal value

### **Answers**

- B
- C
- C
- B
- B
- B
- D
- B
- A
- B
- D
- B
- B
- C
- B