

INTRODUCTORY MACROECONOMICS

CECN 204

TEST # 2

Part 1: Differentiate between: (6 Marks)

1. M1 & M2:

$M1 = \text{Cash in circulation} + \text{Demand deposits (checking accounts)}$

$M2 = M1 + \text{Savings}$

If transfer from Cheq to Sav $\Rightarrow M1 \downarrow$ $M2$ stays same
" " " Sav to Cheq $\Rightarrow M1 \uparrow$ $M2$ stays same.

2. Automatic & Discretionary Fiscal Policy:

These are measures of the FP

Fiscal Policy Measures

- Automatic stabilizers: Such as progressive Income tax, GST, PST, EI
- Discretionary: deliberate actions taken by gov't during periods of recession or inflation

3. Unit banking & Branch banking:

Unit banking: Small individually owned local banks (such as in the USA)

Branch Banking: Big Banks that have thousands of branches (such as in Canada)

4. Schedule 1 & Schedule 2 banks:

Schedule 1: Canadian owned banks, 75% of shares are owned by the Canadians
wholly owned banks

Schedule 2: foreign banks operating in Canada.

5. Bank rate & Prime rate:

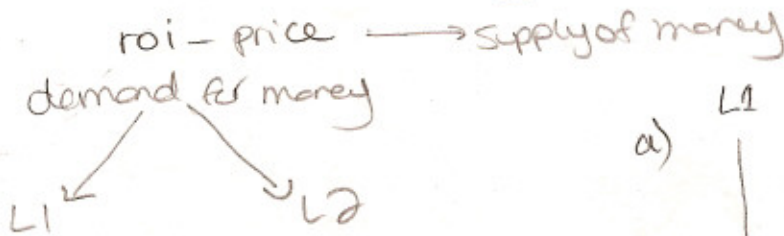
Bank rate:

Paid by chartered banks to central banks for borrowing money from them

Prime rate:

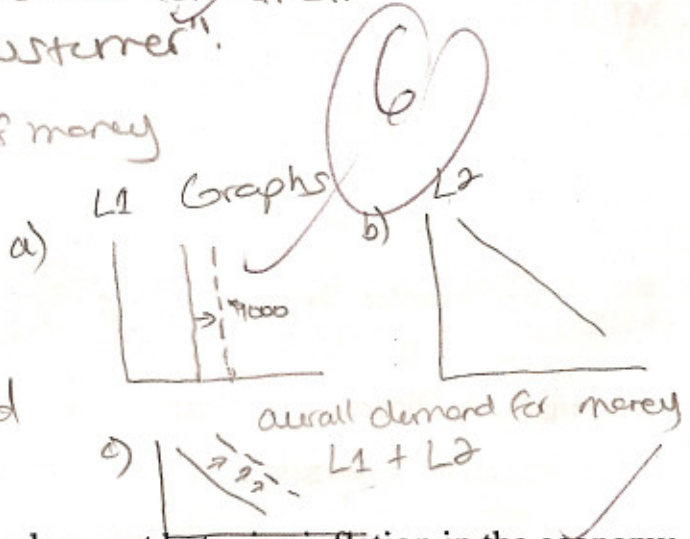
set by chartered banks for their "most credit worthy customer".

6. L1 & L2:



L1 = transaction demand
L2 = speculative/asset demand

Part 2: True or False: (10 Marks)



1. An increase in AD will lower unemployment but raise inflation in the economy. TRUE
2. Appreciation of the Canadian dollar will shift the AD curve to the right. ~~TRUE~~ FALSE
3. Phillip's curve shows the relationship between inflation and GDP. FALSE
4. Stagflation means high GDP and high inflation. FALSE
5. Taxes should be raised to get out of recession. FALSE
6. An annually balanced budget is pro-cyclical, not anti-cyclical TRUE
7. Govt borrowing usually results in higher interest rates. TRUE
8. Face value of 'Token' money is more than it's value as a commodity. TRUE
9. Public deposits are the biggest liability of a chartered bank. TRUE
10. A higher DRR lowers the credit creation capacity of the banking system. TRUE



9

45/20

Part 3 : Circle the right answer : (18 Marks)

1. A rise in the general price level will lead to a/an _____ in the AD curve

- a. Upward movement
- b. Downward movement ✓
- c. Inward shift
- d. Outward shift

2. Which of the following would lead to a rightward shift of the AD curve?

- a. A fall in incomes
- b. A fall in interest rates ✓
- c. A rise in prices
- d. A rise in taxes

3. Which of these will produce a higher price level and lower unemployment?

- a. Reduced G
- b. Rise in I ✓
- c. Increase in labour productivity ✓
- d. Rise in gas prices



4. Supply side economists favor all the following except

- a. Lowering sales taxes ✓
- b. Raising personal income taxes ✗
- c. Reducing corporate income tax ✓
- d. Reducing tax on capital gains ✓

5. 'Laffer's curve' relates

- a. Inflation and unemployment ✓
- b. Inflation and tax rates
- c. Tax rates and unemployment ✗
- d. Tax rates and tax revenue ✓

6. Advocates of a big govt would ↑ G during recessions & ↑ T during inflation

- a. Raise G , raise T ✓
- b. Lower G , lower T
- c. Raise T , raise G
- d. Lower T , lower G

7. Fiscal policy measures to control inflation are

- a. Raise G & raise T
- b. Lower G & lower T
- c. Raise G & lower T
- d. Lower G & raise T

8. _____ is an automatic stabilizer

- a. Progressive income tax
- b. Property tax
- c. Govt expenditure on education
- d. Govt decision to expand a highway

9. Which of the following is not true about govt borrowing ?

- a. It could transfer the burden to a future generation ✓
- b. It redistributes income from the working tax payers to richer bond holders ✓
- c. It could result in 'crowding out' ✓
- d. It lowers interest rates

10. 'Crowding out' means that

- a. I rises at the expense of G
- b. G goes up at the expense of I
- c. C rises at the expense of G
- d. None of the above

11. A run on the bank will occur if

- a. Depositors buy insurance from banks
- b. Other banks do well
- c. Interest rates rise dramatically
- d. Depositors lose confidence in the bank and attempt to withdraw their money

12. If the DRR is 20 %, a deposit of \$ 2000, will eventually raise money supply by

- a. \$ 2,000
- b. \$ 10,000
- c. \$ 8,000
- d. \$ 4,000

Handwritten calculations for question 12:

$$2000 * \frac{1}{.2} = 10000$$
$$2000 * 5 = 10000$$

10000 = 2000 + 1600 + 400

13. If I transfer money to a chequing from a savings account,

- a. M1 falls & M2 rises
- b. M1 rises & M2 falls
- c. M1 falls & M2 remains the same
- d. M1 rises & M2 remains the same

14. When the Central Bank wants to reduce money supply, it can

- a. Buy govt bonds
- b. Sell govt bonds
- c. Ask people to save more
- d. Turn additional sums of money to the finance department

15. The Money Supply curve would shift to the left if there was

- a. A rise in the bank rate
- b. A fall in the required reserve ratio \times
- c. Buying of govt bonds by the BOC \times
- d. A switch in govt deposits to the chartered banks from the BOC \times

16. The transactions demand for money is most closely related to it's function of

- a. Medium of exchange
- b. Measure of value
- c. Standard unit of account
- d. Store of value

17. The 'asset' demand for money

- a. Does not depend on real GDP or price level
- b. Will rise as roi falls
- c. Both 'a' and 'b' are true
- d. Neither 'a' nor 'b' are true

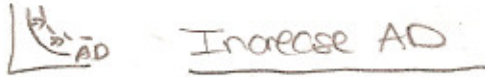
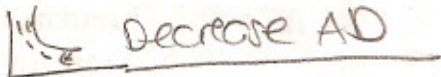
18. If BOC lowers Bank Rate, interest rates will \downarrow , I will \uparrow and GDP will \uparrow

- a. Rise, rise, rise
- b. Fall, fall, fall
- c. Fall, rise, rise
- d. Rise, fall, fall

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Part 4 : Answer any 4 of the following questions : (16 marks)

1. Make a table showing how other factors affect AD.

	 Increase AD	 Decrease AD
Future Expectation	Optimistic	Pessimistic
Fiscal Policy	$\uparrow G, \downarrow T$	$\uparrow T, \downarrow G$
Monetary Policy	$\downarrow r_i$	$\uparrow r_i$
Exchange Rate	appreciates (in respect to foreign \$'s)	depreciates

2. Devise a suitable fiscal policy to control recession and inflation. Why doesn't it always work in practice?

Internal debt does the following:

3. List the ways in which internal debt affects an economy

- ① Lowers gov't services: because of the past debt, we pay interest on these so called party.
 for every \$1 → 1.23 of services (in past)
 for " " → .68 " " (now)
- ② Redistributes income from younger working taxpayer to older richer bondholder
- ③ Leads to the inter-generated transfer of burden
- ④ Leads to crowding out for private businesses
- ⑤ borrowing leads to increased roi

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4. Explain the process of credit creation by the banking system? What are the factors which affect the process?

Primary: A/h is creditor, bank the debtor

Secondary: A/h is debtor, bank creditor

CRR = 20%

fund	Prim	Secondary	Reserved
	1000	800	200
	800 * .2	640	160

Factors

- 1 Initial Deposits.
- 2 CAR / CLR
- 3 willingness to borrow
- 4 Excess Reserves
- Control by Central bank

