

EC140 – Winter 2014 – Midterm 2 Practice Questions

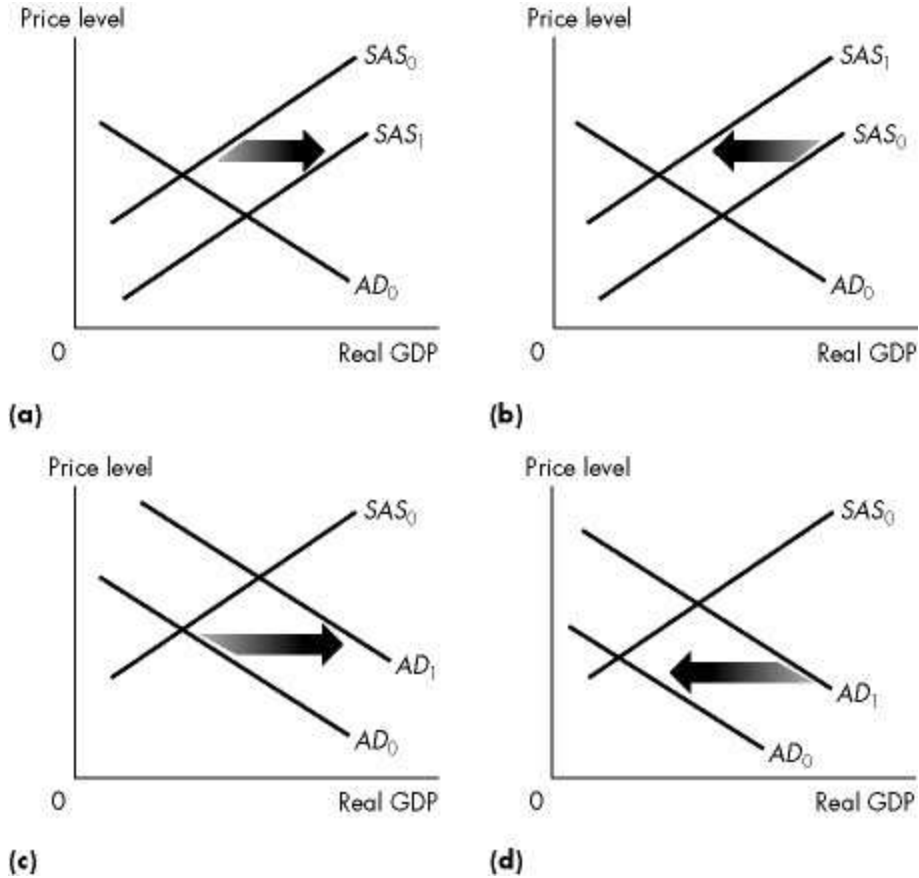


Figure 26.1.1

1) Refer to Figure 26.1.1. Which graph illustrates what happens when factor prices rise?

- a) (a)
- b) (b)
- c) (c)
- d) (d)
- e) (a) and (b)

2) Which one of the following newspaper quotations describes a rightward shift of the *LAS* curve?

- a) "The increase in consumer spending is expected to lead to inflation, without any increase in real GDP."
- b) "Recent higher wage settlements are expected to cause higher inflation this year."
- c) "Growth has been unusually high the last few years due to more women entering the work force."
- d) "The decrease in consumer spending may lead to a recession."
- e) "The recent tornadoes destroyed many factories in Calgary and Edmonton."

3) Everything else remaining the same, the short-run aggregate supply curve shifts rightward if

- a) the full-employment quantity of labour increases.
- b) the quantity of capital decreases.
- c) aggregate demand increases.
- d) the money wage rate increases.
- e) factor prices increase.



4) If a change in wealth is induced by a change in the price level, then this would be shown as a

- a) movement along the aggregate demand curve due to the substitution effects.
- b) movement along the aggregate demand curve.
- c) shift of the aggregate demand curve due to the wealth effect.
- d) shift of the aggregate demand curve due to the substitution effects.
- e) movement along the aggregate supply curve.

5) An economy is at full employment. Which of the following events can create a recessionary gap?

- a) a decrease in the quantity of capital
- b) a decrease in money wages
- c) an increase in taxes
- d) an increase in foreign income
- e) an increase in government spending



6) In the short run, firms expand their production when the price level rises because

- a) wages will fall allowing firms to produce at a lower cost
- b) the higher prices allow the firm to hire more workers by offering higher wages, thereby increasing productivity and profits.
- c) each firm must keep its production up to the level of its rivals, and some firms will expand production as the price level increases.
- d) the money wage rate remains constant so the higher prices for their product makes it profitable for firms to expand production.
- e) none of the above

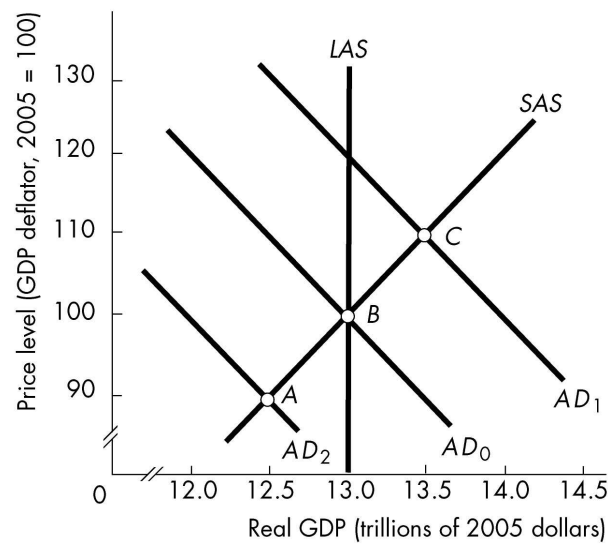


Figure 26.1.2

7) Refer to Figure 26.1.2. Suppose the economy is at point *B*. If firms expect profits will be higher in the future, to what point might the economy's move in the short run?

- a) It shifts to a point such as *A*.
- b) It shifts to a point such as *C*.
- c) It stays at point *B*.
- d) It shifts to *A* then back to *B*
- d) None of the above answers are correct because it is the *SAS* curve that shifts, not the *AD* curve.

8) Moving along the aggregate demand curve, a decrease in the quantity of real GDP demanded is a result of

- a) an increase in income.
- b) a decrease in income.
- c) an increase in the price level.
- d) a decrease in the price level.
- e) an increase in expected future inflation.

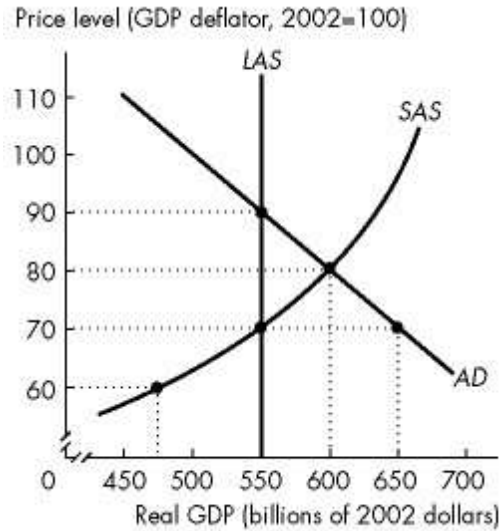


Figure 26.3.2

9) Refer to Figure 26.3.2. Short-run macroeconomic equilibrium real GDP in Mythlo is _____ billion.

- a) \$550
- b) \$475
- c) \$650
- d) \$600
- e) \$500

10) Refer to Figure 26.3.2. If the economy of Mythlo automatically adjusts to long-run equilibrium, then

- a) real GDP is \$600 billion.
- b) the price level rises to 90.
- c) the SAS curve shifts rightward.
- d) potential GDP decreases.
- e) the actual unemployment rate exceeds the natural unemployment rate.

11) Beginning at a long-run equilibrium, an increase in aggregate demand

- a) increases the price level and in the long run increases real GDP.
- b) decreases the price level and in the long run increases real GDP.
- c) increases the price level and in the long run decreases real GDP.
- d) increases the price level, but in the long run there is no change in real GDP.
- e) decreases the price level and in the long run decreases real GDP.

12) We observe an increase in the price level and a decrease in real GDP. Which of the following is a possible explanation?

- a) An increase in expected future profits.
- b) An increase in the quantity of capital.
- c) An increase in expected future income.
- d) An increase in the quantity of money.
- e) An increase in factor prices.



Use the table below to answer the following questions.

Table 26.3.1

Price Level (2002=100)	Aggregate Demand (billions of 2002 dollars)	Short-Run Aggregate Supply (billions of 2002 dollars)	Long-Run Aggregate Supply (billions of 2002 dollars)
100	800	300	600
110	700	400	600
120	600	500	600
130	500	600	600
140	400	700	600

13) Refer to Table 26.3.1. Consider the economy represented in the table. In short-run macroeconomic equilibrium, the price level is _____ and the level of real GDP is _____ billion.

- a) 130; \$500
- b) 120; \$600
- c) 125; \$550
- d) 130; \$600
- e) 120; \$500

14) Consider an economy starting from a position of full employment. Which one of the following occurs as a result of an advance in technology?

- a) Real GDP decreases in the short run.
- b) The price level falls.
- c) An inflationary gap arises.
- d) Factor prices rise in the long run, shifting the short-run aggregate supply curve leftward.
- e) The long-run aggregate supply curve shifts leftward to create the new long-run equilibrium.




15) A rise in the price level

- a) increases aggregate expenditure, but has no effect on the aggregate demand curve.
- b) decreases aggregate expenditure and produces a movement along the aggregate demand curve.
- c) has no effect on aggregate expenditure.
- d) decreases aggregate expenditure and produces a rightward shift of the aggregate demand curve.
- e) decreases aggregate expenditure and produces a leftward shift of the aggregate demand curve.

16) Consider an economy with a multiplier of 2, and a positively-sloped short run aggregate supply curve. If Government expenditure decreases by \$15 billion, then equilibrium real GDP

- a) decreases by less than \$30 billion.
- b) decreases by \$30 billion.
- c) increases by less than \$30 billion.
- d) does not change.
- e) decreases by more than \$30 billion.

17) Suppose that, in the fixed-price Keynesian model, investment increases by \$200, and as a result income increases by \$1000. We conclude that the

- a) slope of the AE curve is 0.8. 
- b) multiplier is 1/5.
- c) slope of the AE curve is 1/5.
- d) multiplier is 0.8.
- e) marginal propensity to spend is 0.2.


18) You are given the following information about the Canadian economy. Autonomous consumption expenditure is \$200 billion, investment is \$200 billion, and government expenditure is \$100 billion. The marginal propensity to consume is 0.7 and net taxes are \$250 billion. Net taxes are assumed to be constant and not vary with income. Exports are \$500 billion and imports are \$450 billion.

The equation of the *AE* curve in billions of dollars is _____. Equilibrium expenditure is _____.


- a) $AE = 0.7Y + 375$; \$1,250 billion
- b) $AE = 0.7 + 375Y$; \$1,250 billion
- c) $AE = 0.7Y + 300$; \$1,000 billion
- d) $AE = 0.7Y + 1,275$; \$4,250 billion
- e) $AE = 0.7Y + 375$; \$536 billion



19) The inflation rate is 5 percent and the real interest rate is positive. Then the nominal interest rate is

- a) less than 5 percent.
- b) 5 percent.
- c) more than 5 percent. 
- d) negative
- e) Without more information it is impossible to tell if the nominal interest rate will be more than, less than, or equal to 5 percent.

20) Which of the following shifts the demand for loanable funds curve leftward?

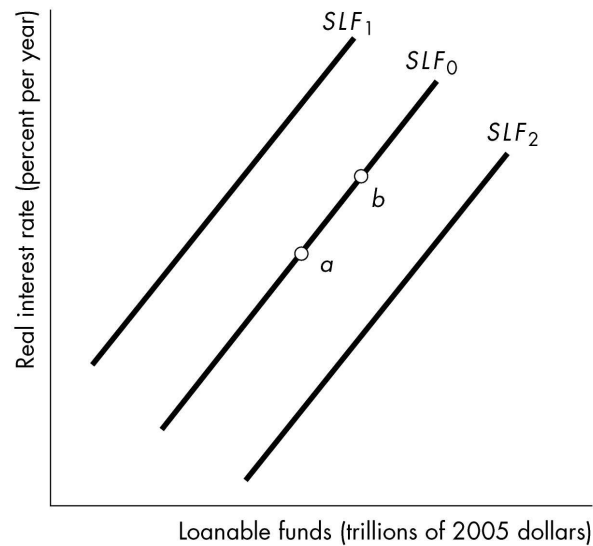
- a) a decrease in the taxes paid by the business
- b) a decrease in the expected profit
- c) a fall in the real interest rate
- d) a rise in the real interest rate 
- e) a government budget surplus

21) Which of the following explains why the demand for loanable funds is negatively related to the real interest rate?

- a) Consumers are willing to spend less and hence save more at higher real interest rates.
- b) A lower real interest rate makes more investment projects profitable.
- c) Interest rate flexibility in financial markets assures an equilibrium in which saving equals investment.
- d) All of the above are reasons why the demand for loanable funds is negatively related to the real interest rate.
- E. None of the above

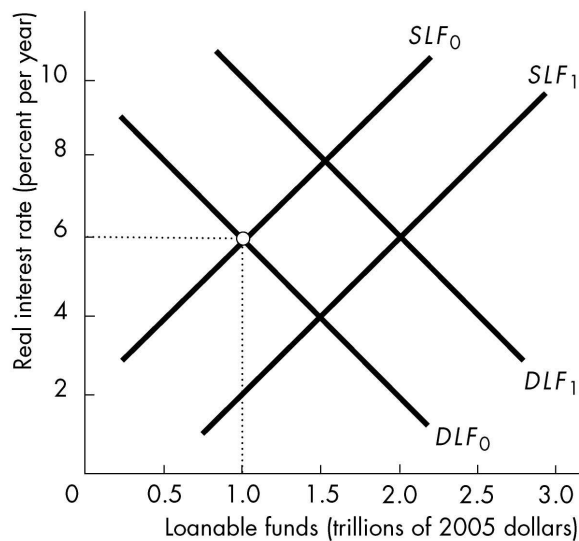
22) A decrease in the government budget deficit decreases the _____ loanable funds and an increase in the government budget surplus increases the _____ loanable funds.

- a) supply of; demand for
- b) demand for; demand for
- c) supply of; supply of
- d) demand for; supply of
- e) none of the above



- 23) In the above figure, the economy is at point a on the initial supply of loanable funds curve SLF_0 . What happens if disposable income decreases?
- The supply of loanable funds curve would shift rightward to a curve such as SLF_2 .
 - The supply of loanable funds curve would shift leftward to a curve such as SLF_1 .
 - There would be a movement to a point such as b on supply of loanable funds curve SLF_0 .
 - Nothing; the economy would remain at point a .
 - None of the above
- 24) In the loanable funds market, the supply comes from
- only saving
 - only saving and the government budget surplus
 - only the government budget surplus and borrowing from the rest of the world
 - saving, the government budget surplus and borrowing from the rest of the world
 - none of the above
- 25) The term "crowding out" relates to the decrease in
- consumption expenditure from an increase in investment.
 - private investment from a government budget deficit.
 - the real interest rate from a government budget deficit.
 - saving from an increase in disposable income.
 - none of the above





26) In the above figure, the initial supply of loanable funds curve is SLF_0 and the demand for loanable funds investment curve is DLF_0 . An increase in the real interest rate to 7 percent could be caused by

- a decrease in the expected profit.
- an increase in people's disposable incomes.
- an expansion that increased both saving and investment by the same amount.
- an increase in investment demand.
- none of the above

27) If the world real interest rate falls, then a country that is a net foreign lender

- does not change the amount of its lending.
- decreases the amount of its lending.
- stops lending.
- increases the amount of its lending.
- None of the above

28) If national saving equals \$100,000, net taxes equal \$100,000 and government expenditure equals \$25,000, what is private saving?

- \$225,000
- \$175,000
- \$25,000
- zero
- \$25,000



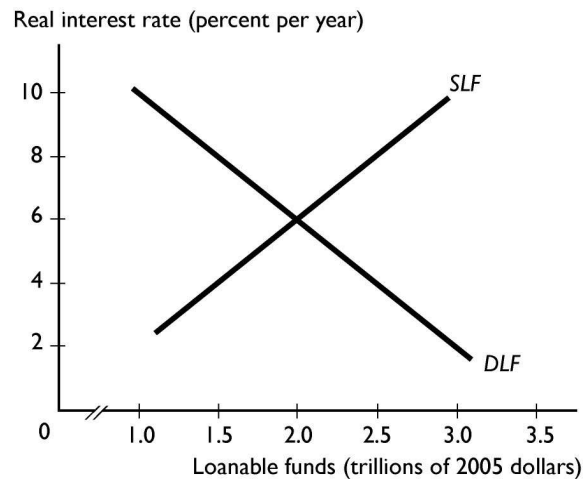
29) Which of the following will shift the supply of loanable funds curve leftward?

- a) a decrease in expected future income
- b) a decrease in the real interest rate
- c) a decrease in default risk
- d) a decrease in real wealth
- e) a decrease in disposable income



30) An increase in wealth leads to _____ loanable funds.

- a) a decrease in the supply of
- b) a decrease in the demand for
- c) an increase in the supply of
- d) an increase in the demand for
- e) no change in either the supply of loanable funds or the demand for



31) The figure above shows the loanable funds market. If the real interest rate is 10 percent, then

- a) there is a shortage in the loanable funds market.
- b) the government must intervene in order to prevent a credit crisis.
- c) savers will exit the market because of the high opportunity cost of saving.
- d) there is a surplus in the loanable funds market.
- e) the interest rate must increase.

32) If there is no Ricardo-Barro effect, an increase in the budget deficit

- a) decreases the demand for loanable funds.
- b) lowers the equilibrium real interest rate.
- c) increases the supply of loanable funds.
- d) increases the amount of investment.
- e) decreases the amount of investment.

33) A small country is a net foreign borrower. Its real interest rate without foreign borrowing is _____ the world real interest rate.

- a) not comparable to
- b) lower than
- c) higher than
- d) either higher than or equal to
- e) equal to

34) When money is accepted as payment in a market transaction, it is functioning as a

- a) medium of exchange.
- b) unit of investment.
- c) store of value.
- d) unit of accounting.
- e) fixed term deposit.

35) Debit cards are not money because

- a) not all banks offer them and not all businesses accept them.
- b) they are instruments to transfer money between people.
- c) they can fail their purpose of being mediums of exchange as a result of technical difficulties.
- d) they can be forged easily.
- e) they are not regulated by the government.

36) If desired reserves are \$150 and deposits are \$1000, what is the desired reserve ratio?

- a) 85 percent
- b) 5 percent
- c) 10 percent
- d) 15 percent
- e) 30 percent

37) If Bank A holds \$200 in reserves, deposits are \$1000, and the desired reserve ratio is 15 percent, how much are excess reserves?

- a) zero, because banks never hold excess reserves
- b) \$50
- c) \$150
- d) \$200
- e) \$250

38) The larger the public's currency drain from the banking system, the

- a) larger is the monetary base.
- b) larger is the money multiplier.
- c) smaller is the monetary base.
- d) smaller is the money multiplier.
- e) none of the above.



39) When the monetary base increases by \$2 billion, the quantity of money increases by \$10 billion. Thus, the money multiplier equals

- a) 5.0
- b) 0.2
- c) 20.0
- d) 2.0
- e) none of the above

Use the figure below to answer the following question.

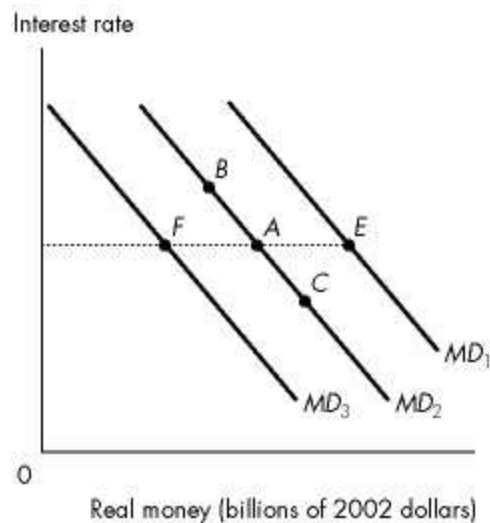


Figure 24.4.2

40) Refer to Figure 24.4.2. Which one of the following best describes the response to an increase in real GDP?

- a) Movement from *A* to *E*
- b) Movement from *B* to *A*
- c) Movement from *A* to *C*
- d) Movement from *A* to *F*
- e) Movement from *E* to *A*

41) The higher and more unpredictable the changes in the monetary unit, the

- a) less likely barter exchange will replace it.
- b) lower the opportunity cost of using it as a store of value.
- c) lower the opportunity cost of using it as a medium of exchange.
- d) higher the opportunity cost of using it as a store of value.
- e) lower the opportunity cost of using it as a standard of deferred payment.

42) Which of the following is most like using a credit card?

- a) writing a cheque on your chequable deposit.
- b) a barter exchange.
- c) taking out a loan.
- d) withdrawing money from a savings account.
- e) using any other form of money, because you can immediately take the goods you purchase home.

43) Which of the following is a store of value?

- a) A debit card.
- b) A credit card.
- c) A cheque.
- d) A fixed term deposit.
- e) All of the above.

44) A bank can create money by

- a) increasing its reserves.
- b) converting reserves into securities.
- c) printing more cheques.
- d) lending its excess reserves.
- e) selling some of its securities.

45) Whenever desired reserves exceed actual reserves, the bank

- a) will go out of business.
- b) will call in loans.
- c) has excess reserves.
- d) can make new loans.
- e) is in a profit-making position.

46) The opportunity cost of holding money increases when the

- a) purchasing power of money increases.
- b) price of goods and services decrease.
- c) income of consumers decreases.
- d) income of consumers increases.
- e) interest rate rises.

47) If the price level doubles, all else constant, the quantity of

- a) real money demanded will half.
- b) real money demanded will double.
- c) nominal money demanded will remain constant.
- d) nominal money demanded will double.
- e) nominal money demanded will half.



48) If households and firms find they are holding more money than desired, they will

- a) buy bonds, and the interest rate will rise.
- b) buy goods, and the price level will rise.
- c) sell bonds, and the interest rate will fall.
- d) sell bonds, and the interest rate will rise.
- e) buy bonds, and the interest rate will fall.

49) According to the quantity theory of money, an increase in the quantity of money will increase the price level

- a) but have no effect on real GDP or the velocity of circulation.
- b) and increase real GDP and the velocity of circulation.
- c) and will have no change in real GDP and a decrease in the velocity of circulation.
- d) and increase real GDP but decrease the velocity of circulation.
- e) and decrease real GDP and increase the velocity of circulation.

50) Suppose that the desired reserve ratio is 0.25 and the currency drain ratio is 0.25. The money multiplier is

- a) 1.71.
- b) 2.40.
- c) 1.40.
- d) 2.50.
- e) 2.08.