

### Multiple Choice (30 Points)

- C 1. When the Federal Reserve raises interest rates, U.S. net exports fall because
- A. short-run output increases
  - B. the user cost of capital rises
  - C. the U.S. dollar appreciates
  - D. consumption falls
  - E. the money supply increases
- D 2. Thomas Malthus' famous prediction that population growth would inevitably lead to episodes of famine and disease did not come true because Malthus overlooked the importance of which factor?
- A. The minimum wage
  - B. Stabilizing monetary policy
  - C. Inflation
  - D. Technological change
  - E. Declining marginal product of labor
- C 3. If a fruit farm grows \$100,000 worth of peaches, sells \$50,000 worth of peaches to consumers and uses the rest to make jam that is sold to consumers for \$100,000, the farm's contribution to GDP is:
- A. \$50,000.
  - B. \$100,000.
  - C. \$150,000.
  - D. \$200,000.
- A 4. In the Keynesian cross diagram, the  $45^\circ$  line represents the short-run equilibrium condition that:
- A.  $Y = PAE$
  - B.  $I > I^p$
  - C.  $I < I^p$
  - D.  $PAE = C + I^p + G + NX$
  - E.  $Y^* = Y$
- A 5. If planned aggregate expenditure (PAE) in an economy equals  $2,000 + 0.8 \times Y$  and potential output ( $Y^*$ ) equals 9,000, then this economy has:
- A. an expansionary gap
  - B. a recessionary gap
  - C. no output gap
  - D. no autonomous expenditure
  - E. no induced expenditure
- B 6. In the short-run Keynesian model where marginal propensity to consume is 0.5, to offset an expansionary gap resulting from a \$1 billion increase in autonomous consumption, government purchases must be:
- A. increased by \$1 billion
  - B. decreased by \$1 billion
  - C. increased by \$2 billion
  - D. decreased by \$2 billion
  - E. increased by \$0.5 billion

- D 7. The benefit of holding money is \_\_\_\_\_, while the opportunity cost of holding money is \_\_\_\_\_.
- A. the nominal interest rate; the fees charge by banks
  - B. the nominal interest rate; its usefulness in carrying out transactions
  - C. increased income; lost purchasing power
  - D. its usefulness in carrying out transactions; the nominal interest rate
  - E. its usefulness in carrying out transactions; the price of wallets and billfolds

- D 8. The financial crisis started in the United States in September 2008 with the collapse of the investment bank Lehman Brothers. What was the reason that caused this crisis?
- A. The Federal Reserve was raising interest rates at the time
  - B. Government spending was falling
  - C. Inflation was rising
  - D. Households were defaulting on their mortgages and house prices fell

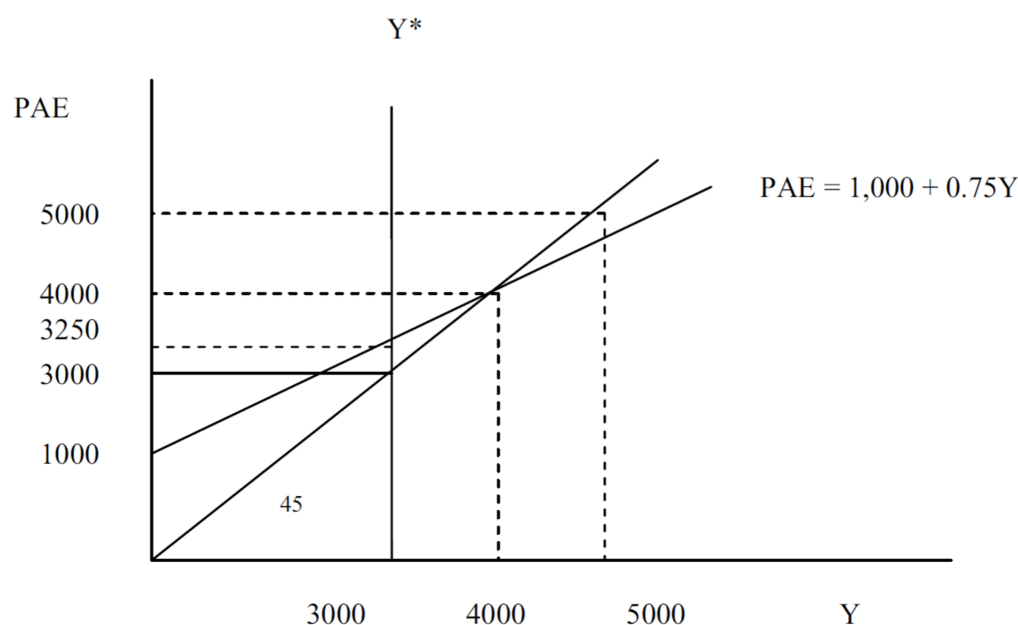
- E 9. Higher nominal interest rates \_\_\_\_\_ the demand for money and higher real income \_\_\_\_\_ the demand for money.
- A. increase; increases
  - B. increase; decreases
  - C. increase; does not change
  - D. decrease; decreases
  - E. decrease; increases

- D 10. If the Federal Reserve wishes to reduce nominal interest rates, it must engage in an open market \_\_\_\_\_ of bonds that \_\_\_\_\_ the money supply.
- A. sale; increases
  - B. sale; decreases
  - C. sales; does not change
  - D. purchase; increases
  - E. purchase; decreases

- C 11. Suppose currency held by the public is \$2000, bank reserves are \$300, and the desired reserve/deposit ratio is 10%. If the Fed sells government bonds to the public in exchange for \$200, then the money supply will \_\_\_\_\_ from \$\_\_\_\_\_ to \$\_\_\_\_\_ assuming that the public does not wish to change the amount of currency it holds.
- A. decrease; 2,000; 1,800
  - B. increase; 2,000; 1,800
  - C. decrease; 5,000; 3,000
  - D. increase; 5,000; 3,000
  - E. decrease; 6,000; 2,000

- h 12. In a country that operates according to Okun's law, real GDP equals \$7,520 billion, potential GDP equals \$8,000 billion and the actual unemployment rate is 8%. What is the natural rate of unemployment in this country?
- A. 5 %
  - B. 6 %
  - C. 7 %
  - D. 8 %

Use the following graph to answer questions 13 and 14.



13. Short-run equilibrium output equals:

- A. 3000
- B. 3250
- C. 4000
- D. 4750
- E. 5000

14. At short-run equilibrium output autonomous expenditure equals \_\_\_\_\_.

- A. 1000
- B. 3000
- C. 3250
- D. 4000
- E. 5000

15. According to the quantity equation, if the Federal Reserve expects velocity to increase by 1% per year, real GDP to increase by 3% per year, and desires a 2% annual rate of inflation, then the money supply should be increased by approximately \_\_\_\_\_ per year.

- A. 1%
- B. 2%
- C. 3%
- D. 4%

16. An example of a government policy to enhance technological progress is:

- A. the construction of interstate highway system.
- B. government support for basic research.
- C. maintaining a well-functioning legal system.
- D. the provision of publicly-funded education.

- B 17. For policymakers, the problem with a recessionary gap is \_\_\_\_\_ and the problem with an expansionary gap is \_\_\_\_\_.
- a tendency for inflation to develop; wasted resources
  - unused resources; a tendency for inflation to develop
  - an increase in cyclical unemployment; an increase in structural unemployment
  - an increase in structural unemployment; an increase in cyclical unemployment
- B 18. If the borrower and lender agree to a loan at 8% when the inflation rate is 3%, then 8% is the \_\_\_\_\_ interest rates and 5% is the \_\_\_\_\_ interest rate.
- real; nominal
  - nominal; real
  - relative; nominal
  - real; relative
- 18 19. Because the U.S. Congress fixes the minimum wage in nominal terms, when there is inflation, the nominal minimum wage \_\_\_\_\_ and the real minimum wage \_\_\_\_\_.
- remains constant; falls
  - remains constant; remains constant
  - remains constant; increases
  - increases; falls
- B 20. Let  $r$  = real interest rate,  $\delta$  = depreciation rate,  $P_k$  = price of capital,  $P$  = price of output, and  $MPK$  = marginal product of capital. Which of the following accurately describes the rule that firms should use to determine the profit-maximizing level of capital?
- $P_k \times MPK = P \times (r + \delta)$
  - $P \times MPK = P_k \times (r + \delta)$
  - $P \times MPK = P_k \times (r - \delta)$
  - $MPK = P \times (r + \delta)$
21. A country in which national saving is less than investment must also have:
- a budget deficit
  - a budget surplus
  - a trade deficit
  - negative capital inflows
22. When a Chinese citizen buys a U.S. government bond, from the perspective of China, this is a(n):
- import
  - export
  - capital outflow
  - capital inflow
23. The dual mandate of the Federal Reserve System does NOT include which of the following?
- price stability
  - zero inflation
  - maximum employment
  - low and stable long-term interest rates

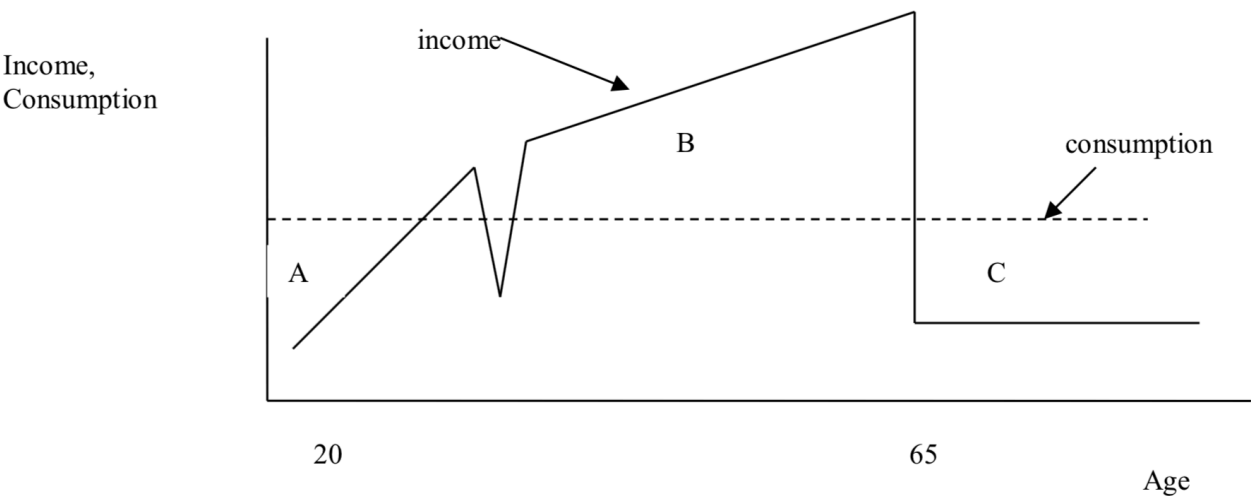
24. A Big Mac in the U.S. costs \$4.75. A Big Mac in China costs ¥15. If the exchange rate is 0.16 \$/¥, in which country is a Big Mac more expensive and by how much?
- 3 times more expensive in China
  - 2 times more expensive in China
  - 3 times more expensive in the U.S.
  - 2 times more expensive in the U.S.
25. In 1929 the CPI was 17.1 and in 1930 the CPI was 16.7. These data provide evidence of a period of \_\_\_\_\_ and we would expect the Federal Reserve to \_\_\_\_\_ the money supply.
- inflation; increase
  - deflation; increase
  - inflation; decrease
  - deflation; decrease
26. If business inventories at the beginning of the year equal \$40 billion and equal \$55 billion at the end of the year, then GDP will:
- decrease by \$15 billion
  - increase by \$15 billion
  - increase by \$40 billion
  - increase by \$55 billion
27. Based on the following information, calculate the value of the M1 measure of the money supply.
- |                                  |     |
|----------------------------------|-----|
| Currency                         | 20  |
| Demand deposits                  | 30  |
| Money market mutual funds        | 80  |
| Travelers' checks                | 5   |
| Saving deposits                  | 180 |
| Other checkable deposits         | 20  |
| Small denomination time deposits | 110 |
- \$55 billion
  - \$75 billion
  - \$255 billion
  - \$370 billion
  - \$445 billion

28. A family has the following assets and liabilities:

Two cars	\$15,000
House	\$400,000
Mortgage	\$300,000
Cash	\$1,000
Car loans	\$5,000
Checking account balance	\$3,000
Credit card balance	\$3,000

What is the family’s wealth (e.g. net worth)?

- A. \$105,000
  - B. \$107,000
  - C. \$111,000
  - D. \$419,000
  - E. \$727,000
29. Regular payments made to stockholders are called \_\_\_\_\_.
- A. diversifications
  - B. reserves
  - C. coupons
  - D. dividends
  - E. principals
30. The following graph shows income and consumption over an individual’s life.



According to the graph, this person is saving during \_\_\_\_\_, dissaving during \_\_\_\_\_, and borrowing during \_\_\_\_\_.

- A. A, B, C
- B. B, C, A
- C. C, A, B
- D. A, C, B