Chapter 9: From the Short to the Medium Run: The IS-LM-PC Model

1) The Phillips curve shows that when the unemployment rate is lower than the natural rate,
A) inflation is higher than expected.
B) inflation is lower than expected.
C) policy rate is higher than expected.
D) policy rate is lower than expected.

2) The Phillips curve shows that when the unemployment rate is higher than the natural rate,
A) inflation is higher than expected.
B) inflation is lower than expected.
C) policy rate is higher than expected.
D) policy rate is lower than expected.

3) Okun's law shows that when the unemployment rate is above the natural rate,
A) inflation is higher than expected.
B) inflation is lower than expected.
C) output is below potential.
D) output is above potential.

4) Okun's law shows that when the unemployment rate is below the natural rate,
A) inflation is higher than expected.
B) inflation is lower than expected.
C) output is below potential.
D) output is above potential.

5) Disposable income equals
A) income minus saving.
B) income minus both saving and taxes.
C) consumption minus taxes.
D) the sum of consumption and saving.
E) none of these

6) In the IS-LM-PC model, which of the following is assumed to be exogenous?
A) G
B) C
C) I
D) Y

7) In the IS-LM-PC model, investment does not depend on
A) T.
B) Y.
C) r.
D) x.

8) In the IS-LM-PC model, LM curve is
A) flat.

B) upward sloping.
C) downward sloping.
D) vertical.

9) The change in the unemployment rate is approximately equal to
A) the negative of the growth rate of output.
B) the negative policy rate.
C) the negative inflation rate.
D) the negative of the growth rate of money supply.

10) The natural rate of interest is *not*
A) zero.
B) the neutral rate of interest.
C) Wicksellian rate of interest.
D) associated with the natural rate of unemployment.

11) If the output is too high, to achieve the medium run equilibrium, the central bank will
A) increases policy rate.
B) reduces policy rate.
C) increase money supply.
D) increases inflation rate.

12) If the output is too low, to achieve the medium run equilibrium, the central bank will
A) increases policy rate.
B) reduces policy rate.
C) increase money supply.
D) increases inflation rate.

13) The zero lower bound refers to the situation that
A) the lowest the central bank can decrease the nominal policy rate is 0%.
B) real interest rate is 0%.
C) inflation rate is 0%.
D) risk premium is 0%.

14) When the policy rate increases,
A) IS curve does not change.
B) IS curve shifts to the right.
C) IS curve shifts to the left.
D) LM curve shifts upward.
E) LM curve shifts downward.

15) When the policy rate decreases,
A) IS curve does not change.
B) IS curve shifts to the right.
C) IS curve shifts to the left.
D) LM curve shifts upward.
E) LM curve shifts downward.

16) When a government reduces its deficits by increasing taxes, in the medium run,
A) output returns to potential.
B) output increases.
C) interest rate is higher.
D) IS curve shifts inward to the left.

17) When a government reduces its deficits by increasing taxes, in the short run,
A) output returns to potential.
B) output increases.
C) interest rate is higher.
D) IS curve shifts inward to the left.

18) As fiscal consolidation takes place, the central bank should
A) decrease the policy rate.
B) increase the policy rate.
C) increase inflation rate.
D) decrease money supply.

19) In the short run, a reduction in the price of oil will cause
A) a reduction in output.
B) an increase in the price level.
C) a reduction in the interest rate.
D) all of these
E) none of these

20) The wage setting relation is
A) downward sloping.
B) upward sloping.
C) vertical.
D) horizontal.

21) The price setting relation is
A) horizontal.
B) upward sloping.
C) downward sloping.
D) vertical.

22) An increase in the price of oil will cause which of the following in the medium run?
A) no change in the level of output
B) no change in the price level
C) an increase in the unemployment rate
D) a reduction in the interest rate
E) none of these

23) For this question, assume that the economy is initially operating at the natural level of output. An increase in the price of oil will cause which of the following in the medium run?

A) a reduction in the interest rate
B) a reduction in output and an increase in the aggregate price level
C) a reduction in output and a reduction in the interest rate
D) a reduction in unemployment, an increase in the nominal wage and an increase in the aggregate price level
E) a reduction in the aggregate price level and no change in output

24) For this question, assume that the economy is initially operating at the natural level of output. A reduction in consumer confidence will cause
A) an increase in the real wage in the medium run.
B) a reduction in the real wage in the medium run.
C) no change in the real wage in the medium run.
D) ambiguous effects on the real wage in the medium run.

25) For this question, assume that the economy is initially operating at the natural level of output. A reduction in taxes will cause
A) an increase in the real wage in the medium run.
B) a reduction in the real wage in the medium run.
C) no change in the nominal wage in the medium run.
D) ambiguous effects on the real wage in the medium run.
E) none of these

26) For this question, assume that the economy is initially operating at the natural level of output. An increase in unemployment benefits will cause
A) an increase in the real wage in the medium run.
B) a reduction in the real wage in the medium run.
C) no change in the real wage in the medium run.
D) ambiguous effects on the real wage in the medium run.

27) For this question, assume that the economy is initially operating at the natural level of output. A monetary expansion will cause
A) no change in the real wage in the medium run.
B) an increase in investment in the medium run.
C) a reduction in the interest rate in the medium run.
D) no change in the nominal wage in the medium run.

28) In the short run, an increase in the price of oil will cause
A) an increase in output.
B) a reduction in the price level.
C) an increase in the interest rate.
D) all of these
E) none of these

29) For this question, assume that the economy is initially operating at the natural level of output. An increase in consumer confidence will cause
A) a reduction in the real wage in the medium run.
B) an increase in the real wage in the medium run.

C) no change in the real wage in the medium run.
D) ambiguous effects on the real wage in the medium run.

30) which of the following is not an example of a shock to the economy?
A) A firm shuts down.
B) increase in oil price
C) sudden decline in consumer confidence
D) sharp drop in investment spending