DEPARTMENT OF ECONOMICS
College of Business and Economics

ECON*1100 - Introductory Macroeconomics

WINTER 2017 MIDTERM 2 Version 1

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<u>IMPORTANT</u>:

☞ Please turn your cell phones off. Put away everything other than several pencils and an eraser. You may have a drink on your desk as well but NO food.

☞ Fill out the scantron form NOW. Write your name and username in the spaces provided and FILL in the bubbles (circles) below. You don't need to fill in the *section* of the course

☞ Basic Calculators are Permitted

☞ There are **70** multiple choice questions. The exam lasts 100 minutes.

☞ Read each question **carefully**.

☞ There are **8 pages** in this examination, including this cover sheet and the worksheet on the back. Count them.

☞ You may rip off the last page to use as scrap paper

☞ **Record your answers on the exam <u>and</u> the WHITE computer scantron form that came with your exam booklet. Do this as you write the exam – you won't have time to do this at the conclusion of the exam.**

☞ **You can KEEP the exam booklet – TURN IN your completed scantron form**

☞ **GOOD LUCK!**

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question
.

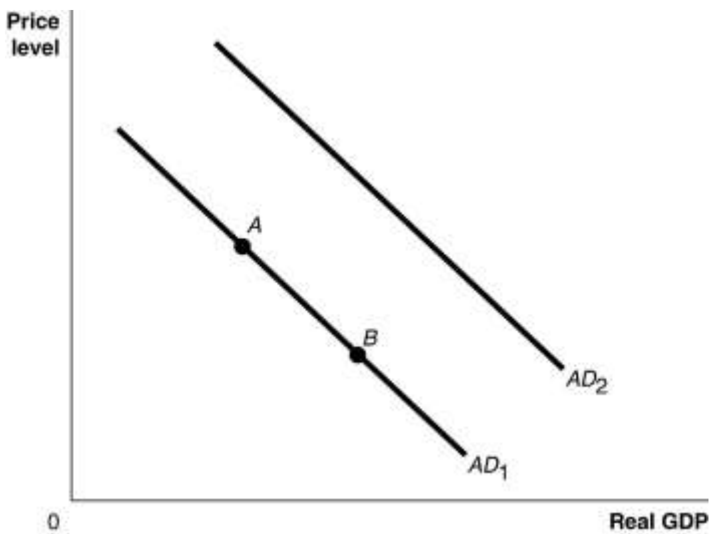
1) An increase in the price level results in a(n) ________ in the quantity of real GDP demanded because ________.

A) increase; a higher price level increases consumption, investment, and net exports
B) increase; a higher price level reduces consumption, investment, and net exports
C) decrease; a higher price level increases consumption, investment, and net exports
D) decrease; a higher price level reduces consumption, investment, and net exports

2) If aggregate demand just increased, which of the following may have caused the increase?

A) an increase in the interest rate
B) an increase in government purchases
C) an increase in imports
D) an increase in the price level
E) all of the above

Figure 9.1



3) ***Refer to Figure 9.1.*** *Ceteris paribus,* a decrease in the growth rate of domestic GDP relative to the growth rate of foreign GDP would be represented by a movement from

A) AD_1 to AD_2. B) AD_2 to AD_1. C) point *A* to point *B*. D) point *B* to point *A*.

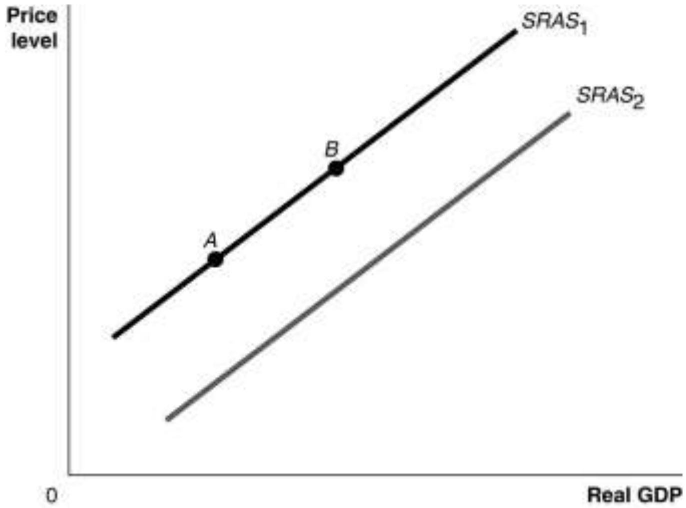
4) Changes in the price level

A) do not affect the level of aggregate supply in the long run.
B) decrease the level of aggregate supply in the long run.
C) increase the level of aggregate supply in the long run.
D) increase the level of aggregate supply in the long run only at very high levels of output.

5) Workers expect inflation to rise from 3% to 5% next year. As a result, this should

A) shift the short-run aggregate supply curve to the left.
B) shift the short-run aggregate supply curve to the right.
C) move the economy down along a stationary short-run aggregate supply curve.
D) move the economy up along a stationary short-run aggregate supply curve.

Figure 9.3

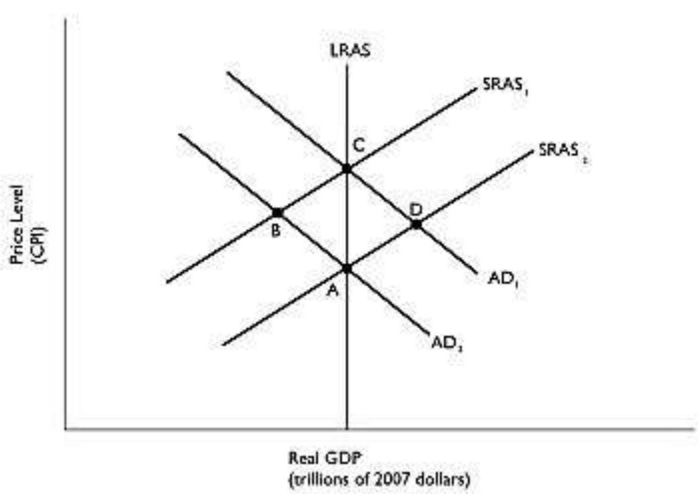


6) ***Refer to Figure 9.3.*** *Ceteris paribus*, a decrease in the capital stock would be represented by a movement from
   A) $SRAS_1$ to $SRAS_2$. B) $SRAS_2$ to $SRAS_1$. C) point *A* to point *B*. D) point *B* to point *A*.

7) An increase in aggregate demand causes an increase in ________ only in the short run, but causes an increase in ________ in both the short run and the long run.
   A) real GDP; the price level
   B) the price level; real GDP
   C) real GDP; real GDP
   D) the price level; the price level

8) Suppose the economy is at a short–run equilibrium GDP that lies below potential GDP. Which of the following will occur because of the automatic mechanism adjusting the economy back to potential GDP?
   A) Prices will increase.
   B) Unemployment will rise.
   C) Short–run aggregate supply will shift to the right.
   D) Output will decrease.

Figure 9.5

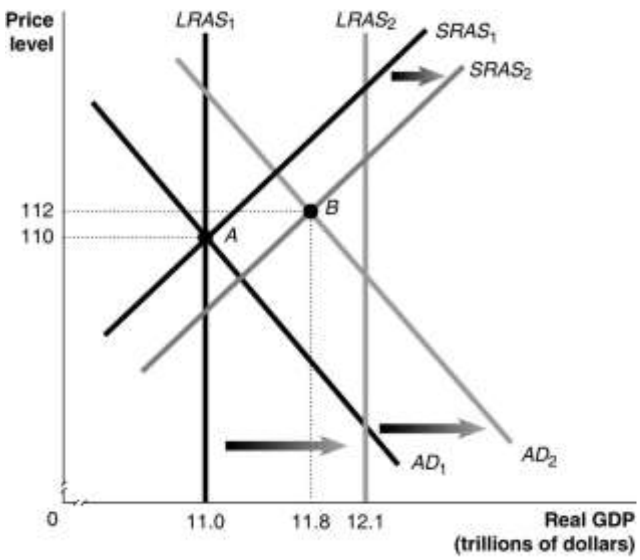


9) ***Refer to Figure 9.5.*** Suppose the economy is at point *C*. If government spending decreases in the economy, where will the eventual long–run equilibrium be?
   A) *A* B) *B* C) *C* D) *D*

10) Stagflation usually results from

A) a decrease in aggregate demand.
B) an increase in aggregate supply.
C) an increase in aggregate demand.
D) a supply shock.

Figure 9.7



11) ***Refer to Figure 9.7.*** Given the economy is at point *A* in year 1, what will happen to the unemployment rate in year 2?

A) It will fall.
B) It will rise.
C) It will remain constant.
D) There is not enough information to answer the question.

12) Which of the following could explain why there is an increase in potential GDP but the equilibrium level of GDP does not rise?

A) *AD* shifted to the right by more than *SRAS*.
B) *SRAS* shifted to the right by more than *LRAS*.
C) *AD* shifted to the right by less than *SRAS*.
D) *SRAS* and *AD* do not shift.

13) Which of the following models relies on emphasizing the importance of sticky wages and prices?

A) the real business cycle model
B) the new classical model
C) the new Keynesian model
D) the monetarist model

14) Economies where goods and services are traded directly for other goods and services are called ________ economies.

A) barter
B) trade
C) direct
D) seigniorage

15) Fiat money has

A) value, because it can be redeemed for gold by the central bank.
B) a great intrinsic value that is independent of its use as money.
C) little to no intrinsic value but is backed by the quantity of gold held by the central bank.
D) little to no intrinsic value and is authorized by the central bank or governmental body.

16) Money's most narrow definition is based on its function as a
A) unit of account.
B) standard of deferred payment.
C) medium of exchange.
D) store of value.
E) standard of barter.

Scenario 10.1

Currency	$1,000
Chequing Account Balances	2,000
Savings Account Balances	5,000
Fixed Term Deposits	6,000
Non-Money Market Fund Shares	7,000

Consider the information above for a simple economy. Assume there are no travellers' cheques.

17) ***Refer to Scenario 10.1.*** M1+ in this simple economy equals
A) $1,000. B) $2,000. C) $3,000. D) $8,000.

18) A bank will consider a car loan to a customer to be ________ and a customer's chequing account to be ________.
A) a liability; a liability
B) an asset; an asset
C) an asset; net worth
D) a liability; an asset
E) an asset; a liability

19) Suppose that you deposit $2,000 in your bank and the desired reserve ratio is 10 percent. The maximum loan your bank can made as a direct result of your deposit is
A) $200. B) $1,800. C) $2,000. D) $20,000.

20) Suppose Kevin O'Leary deposits $20 million into his chequing account at the Royal Bank. If the Royal Bank has a desired reserve ratio of 10 percent, what is the maximum change in money supply?
A) –$200 million
B) –$180 million
C) $2 million
D) $180 million
E) $200 million

21) The bank rate is
A) the interest the Bank of Canada charges to lend to financial institutions.
B) the interest rate consumers pay when they borrow from the bank.
C) the interest rates at which banks lend to each other.
D) the rate at which banks are taxed on their profits.

22) The Bank of Canada uses open market operations to
A) ensure commercial banks remain profitable.
B) reinforce its target for the overnight interest rate.
C) reduce the federal government's cost of running a deficit.
D) limit the federal government debt.

23) To increase the money supply, the Bank of Canada could
   A) decrease income taxes.
   B) raise the required reserve ratio.
   C) raise the discount rate.
   D) lower transfer payments.
   E) enter into a purchase and resale agreement.

24) The goal of the Bank of Canada's monetary policy is
   A) to keep the inflation rate between 1 and 3 percent.
   B) to keep the money supply growing at a rate of 2 percent per year.
   C) to keep the unemployment rate below 8 percent.
   D) to keep mortgage rates below 10 percent.

25) According to the quantity theory of money, deflation will occur if the
   A) money supply is more than real GDP.
   B) money supply grows at a faster rate than real GDP.
   C) money supply is less than real GDP.
   D) money supply grows at a slower rate than real GDP.

26) Which of the following is *not* a consequence of hyperinflation?
   A) It causes an economy to suffer slow growth.
   B) The price level grows in excess of hundreds of percentage points per year.
   C) Money loses value so rapidly that firms and individuals stop holding it.
   D) Money's function as a medium of exchange is enhanced.

27) If the reserve ratio changed from 1% to 8% what would happen to the money multiplier (MM) and the money supply (MS)?
   A) Both increase
   B) Both decrease
   C) MS increase and MM decrease
   D) MS decrease and MM increase

28) Monetary policy refers to the actions the
   A) Bank of Canada takes to manage the money supply and interest rates to pursue its macroeconomic policy objectives.
   B) Prime Minister and Parliament take to manage government spending and taxes to pursue their economic objectives.
   C) Prime Minister and Parliament take to manage the money supply and interest rates to pursue their economic objectives.
   D) Bank of Canada takes to manage government spending and taxes to pursue its economic objectives.

29) Which of the following would cause the money demand curve to shift to the right?
   A) an increase in the interest rate
   B) an increase in the price level
   C) a decrease in real GDP
   D) an open market purchase of Government of Canada securities by the Bank of Canada

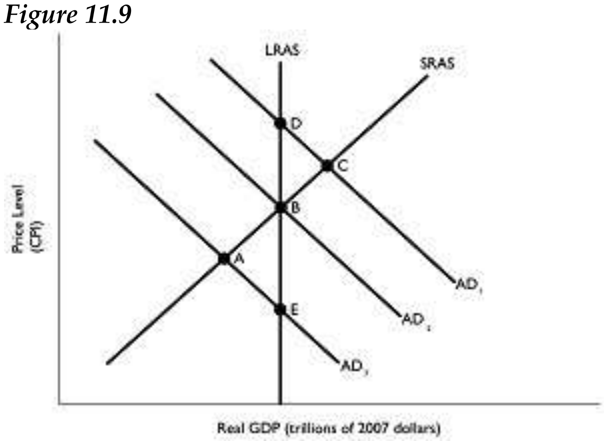
30) Suppose that households became mistrustful of the banking system and decide to decrease their chequing accounts and increase their holdings of currency. Using the money demand and money supply model and assuming everything else is held constant, the equilibrium interest rate should
   A) increase.
   B) decrease.
   C) not change.
   D) increase, then decrease.

31) When the Bank of Canada increases the money supply, at the previous equilibrium interest rate households and firms will now have
A) to sell Treasury bills.
B) more money than they want to hold.
C) less money than they want to hold.
D) the amount of money that they want to hold.

32) The Bank of Canada can reduce the overnight interest rate by
A) selling Canada bonds, which decreases bank reserves.
B) buying Canada bonds, which decreases bank reserves.
C) buying Canada bonds, which increases bank reserves.
D) selling Canada bonds, which increases bank reserves.

33) The ability of the Bank of Canada to use monetary policy to affect economic variables such as real GDP ultimately depends upon its ability to affect
A) nominal interest rates.
B) foreign exchange rates.
C) tax rates.
D) real interest rates.

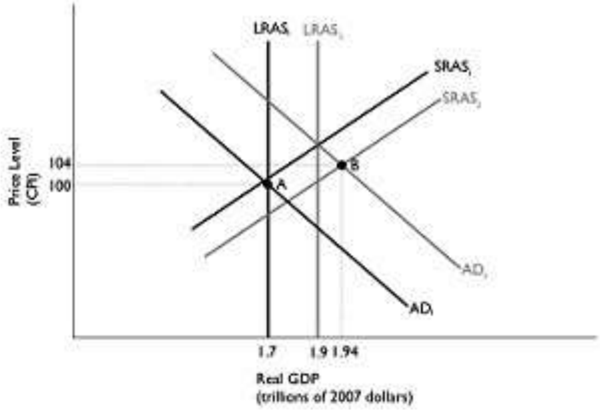
Figure 11.9



34) ***Refer to Figure 11.9.*** Suppose the economy is in a recession and the Bank of Canada pursues an expansionary monetary policy. Using the static *AD*–*AS* model in the figure above, this would be depicted as a movement from
A) *C* to *D*.
B) *A* to *B*.
C) *C* to *B*.
D) *A* to *E*.
E) *B* to *C*.

35) ***Refer to Figure 11.9.*** Suppose the economy is in a recession and no policy is pursued. Using the static *AD*–*AS* model in the figure above, this situation would be depicted as a movement from
A) *A* to *B*.
B) *C* to *D*.
C) *B* to *A*.
D) *C* to *B*.
E) *A* to *E*.

Figure 11.14



36) ***Refer to Figure 11.14.*** In the dynamic *AD*–*AS* model, if the economy is at point *A* in year 1 and is expected to go to point *B* in year 2, and the Bank of Canada pursues no policy, then at point *B*
   A) the unemployment rate is greater than the natural rate of unemployment.
   B) firms are producing above normal capacity.
   C) incomes and profits are falling.
   D) there is pressure on wages and prices to rise.
   E) both B) and D)

37) From an initial long–run macroeconomic equilibrium, if the Bank of Canada anticipated that next year aggregate demand would grow significantly slower than long–run aggregate supply, then the Bank of Canada would most likely
   A) increase income tax rates.
   B) decrease interest rates.
   C) decrease income tax rates.
   D) increase interest rates.

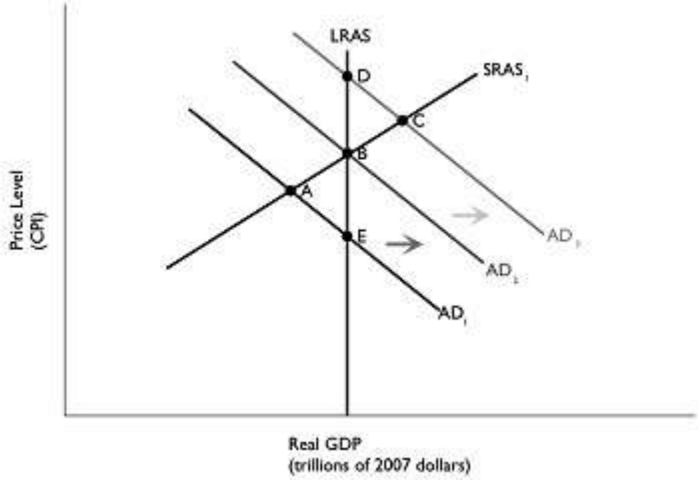
38) The Bank of Canada cannot target both the money supply and the interest rate because it does not control
   A) money demand.
   B) open market operations.
   C) the discount rate.
   D) bank reserves.

39) If the Bank of Canada targets the interest rate and the money demand curve shifts to the left, then the Bank of Canada
   A) can maintain the interest rate target, but at a higher quantity of the money supply.
   B) cannot maintain the interest rate target.
   C) can maintain the interest rate target, but at a lower quantity of the money supply.
   D) can maintain the interest rate target with no change in the money supply.

40) Using the Taylor rule, if the current inflation rate equals the target inflation rate and real GDP equals potential GDP, then the overnight interest rate target rate equals the
   A) current discount rate.
   B) real equilibrium federal funds rate.
   C) current inflation rate plus the real equilibrium overnight interest rate.
   D) current inflation rate.

41) The increase in government spending on Employment Insurance payments to workers who lose their jobs during a recession and the decrease in government spending on unemployment insurance payments to workers during an expansion is an example of
   A) automatic monetary policy.
   B) automatic stabilizers.
   C) discretionary fiscal policy.
   D) discretionary monetary policy.

Figure 12.1



42) ***Refer to Figure 12.1.*** Suppose the economy is in a recession and expansionary fiscal policy is pursued. Using the static *AD*–*AS* model in the figure above, this would be depicted as a movement from

A) *A* to *B*.
B) *B* to *C*.
C) *C* to *B*.
D) *B* to *A*.
E) *A* to *E*.

43) If the economy is falling below potential real GDP, which of the following would be an appropriate fiscal policy to bring the economy back to long–run aggregate supply?

A) an increase in taxes
B) an increase in the money supply and a decrease in interest rates
C) an increase in oil prices
D) an increase in government purchases

44) From an initial long–run equilibrium, if aggregate demand grows more slowly than long–run and short–run aggregate supply, the federal government would most likely

A) decrease taxes.
B) increase the required reserve ratio and decrease government spending.
C) lower interest rates.
D) decrease oil prices.
E) decrease government spending.

45) Which of the following would be most likely to induce the federal government to conduct contractionary fiscal policy?

A) a significant decrease in real GDP
B) a significant increase in labour productivity
C) a significant increase in inflation
D) a significant decrease in oil prices

46) Which of the following would increase the size of the government purchases multiplier?

A) a decrease in the amount saved by households from an increase in income
B) an increase in the quantity of imports purchased by households from an increase in income
C) a decrease in the amount of consumption spending by households from an increase in income
D) an increase in the tax rate

47) An increase in the sensitivity of private spending (consumption, investment, and net exports) to changes in the interest rate ________ the government purchases multiplier due to the crowding out effect.

A) will not change
B) will increase
C) will decrease
D) may increase or may decrease

48) A recession tends to cause the federal budget deficit to ________ because tax revenues ________ and government spending on transfer payments ________.
A) increase; fall; rises
B) decrease; fall; rises
C) increase; rise; falls
D) decrease; rise; falls

49) The cyclically adjusted budget deficit or surplus measures what the deficit or surplus would be if the economy was
A) at potential tax revenue.
B) at potential GDP.
C) in an expansion.
D) in a recession.

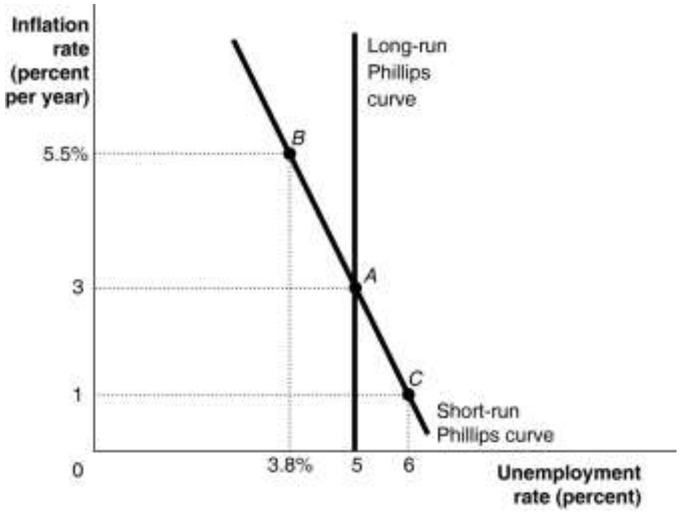
50) Which of the following best describes supply–side economics?
A) Tax rates, particularly marginal tax rates, affect the incentive to work, save, and invest and, therefore, aggregate supply.
B) Education affects the incentive to work, save, and invest and, therefore, aggregate supply.
C) Education affects labour productivity which affects aggregate supply.
D) Labour productivity affects aggregate supply.

51) In an open economy, the government purchases multiplier will be
A) larger as the marginal propensity to import decreases.
B) smaller as the marginal propensity to import decreases.
C) smaller as the marginal propensity to tax decreases.
D) larger as the marginal propensity to consume decreases.

52) Gretchen expects the price level to rise from 104 this year to 108 next year, and she is able to incorporate these expectations into her wage contract. If the price level rises to 106 next year instead of 108, which of the following will occur?
A) Gretchen's real wage may rise or fall, depending on the unemployment rate.
B) Gretchen's real wage will rise.
C) Gretchen's real wage will fall.
D) Gretchen's real wage will be unchanged.

53) If actual inflation is less than expected inflation, actual real wages will be ________ expected real wages and unemployment will ________.
A) greater than; fall
B) less than; rise
C) less than; fall
D) greater than; rise

Figure 13.2



54) ***Refer to Figure 13.2.*** Suppose the economy is at point *C*. If the Bank of Canada increases the money supply so that inflation increases, the economy will ________ in the short run, holding all else constant.
A) eventually move to point *A*
B) stay at point *C*
C) eventually move to point *B*
D) move to point *A* and then back to point *C*

55) If expected inflation rises, the long-run Phillips curve will
A) shift to the right.
B) become negatively sloped.
C) not be affected.
D) shift to the left.

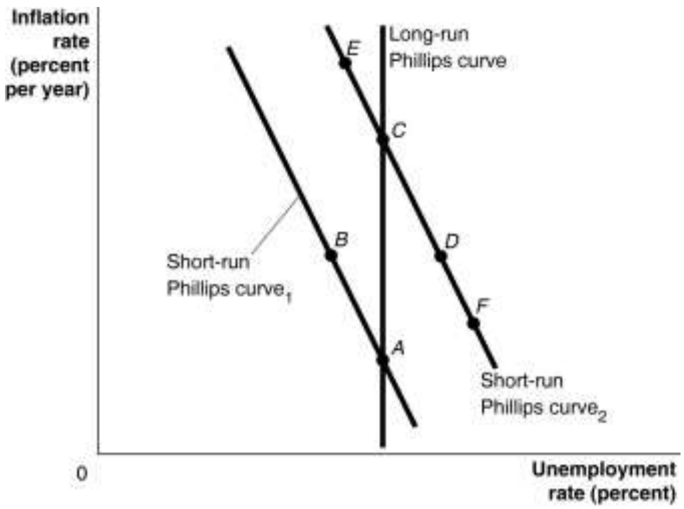
56) If the Bank of Canada attempts to continue reducing unemployment by manipulating monetary policy, which of the following would you expect to see?
A) The Bank of Canada will reduce the natural rate of unemployment.
B) The Bank of Canada will follow deflationary monetary policies.
C) The Bank of Canada will follow inflationary monetary policies.
D) The rate of inflation will fall as the Bank of Canada tries to reduce the unemployment rate.

57) According to real business cycle models,
A) unexpected changes in monetary policy are the major source of fluctuations in real GDP.
B) the long-run Phillips curve is negatively sloped.
C) the economy is normally operating below the natural rate of unemployment.
D) the economy is normally at potential GDP.

58) A falling price level is called ________ and a fall in the rate of inflation is called ________.
A) disinflation; deflation
B) a contraction; disinflation
C) disinflation; a contraction
D) deflation; disinflation

59) What impact does expansionary monetary policy have on the short-run Phillips curve if consumers and firms expect the expansionary monetary policy to increase inflation?
A) The short-run Phillips curve becomes the long-run Phillips curve.
B) The short-run Phillips curve shifts down.
C) The short-run Phillips curve shifts up.
D) The short-run Phillips curve is not affected by expansionary monetary policy.

Figure 13.11



60) ***Refer to Figure 13.11.*** A supply shock, such as rising oil prices, would be depicted as a movement from ________.

A) *C* to *B* to *A* B) *A* to *B* to *C* C) *C* to *E* to *B* D) *C* to *D* to *A* E) *A* to *D* to *C*

61) If MPC=0.8, taxes=T , and MPI=0, the balanced budget multiplier is

A) 0 B) 5 C) 1 D) –1

For questions 62 – 65 you are given the following information:

C = 100+0.9Y
T = 100+0.1Y
I =100
G =125
NX = 50 – 0.21Y

62) What is the size of the government spending multiplier?

A) 2.5 B) 2.44 C) 10 D) 1.67

63) What is the size of the tax multiplier?

A) –1.5 B) –2.2 C) –9 D) –2.25

64) If potential GDP is 750B, what is the appropriate fiscal policy?

A) G increase 32.86B; or T decrease 36.6B
B) G decrease 185B or T decrease 205.6B
C) G Increase 15B or T decrease 16.67B
D) G increase 164.1B; or T decrease 30.45B

65) Which of the following combination will have the highest multiplier?

A) mpc = 0.8 t = 0.2 mpi = 0.1
B) mpc = 0.9 t = 0.2 mpi = 0.2
C) mpc = 0.8 t = 0.3 mpi = 0.2
D) mpc = 0.9 t = 0.3 mpi = 0.2

66) A sales tax is an example of

A) A corporate tax system
B) A flat tax system
C) A progressive tax system
D) A regressive tax system

67) Which of the following is not a government debt instrument

A) Savings bonds B) Treasury bills C) Mortgages D) Bonds

68) Which economist wrote about optimal currency areas and worked for the IMF?

A) Sir William Petty
B) Lord John Maynard Keyees
C) Robert Mundell
D) Abba Lenner

69) Which combination of people and ideas is incorrect?

A) Minsky and the asset bubbles bursting
B) Hayek and the rational expectations
C) Keynes and the paradox of theft
D) Friedman and the quantity theory of money

70) Stagflation is the twin problems of

A) Budget deficits and trade deficits
B) Unemployment and inflation
C) Trade deficits and inflation
D) Budget deficits and inflation