**Name**:

**ID:**

**Department of Economics**

**Iowa State University**

**Principles of Macroeconomics**

Spring 2011, Midterm 3

**<u>Do Not Open This Booklet Until Told To Do So.</u>**

**Directions:**

- Print your name and University ID number on this page

- Fill in your name, birth date, and ID on the bubble sheet, and write the exam version at the top of the bubble sheet. The exam version is listed at the bottom of the page.

- Answer multiple choice questions on the bubble-sheet, and answer the rest of the questions in this book.

- There are 55 points total on the exam.

**Multiple Choice Questions**: **2 points each.** Please answer on your bubble sheet.

1. The Fed's main assets are:
   A)   corporate stocks and bonds.
   B)   U.S. Treasury bills.
   C)   currency in circulation and bank reserves.
   D)   the facilities of the twelve district banks.

2. The money multiplier is equal to:
   A)   the money supply divided by the reserve ratio.
   B)   the ratio of the monetary base to the money supply.
   C)   about 3.9 in the United States.
   D)   the ratio of the money supply to the monetary base.

3. In the long run, the aggregate price level has:
   A)   a positive effect on the quantity of aggregate output.
   B)   an impact on aggregate output but no impact on employment.
   C)   a negative effect on the quantity of aggregate output.
   D)   no effect on the quantity of aggregate output.

4. The narrowest definition of money excludes:
   A)   currency in circulation.
   B)   checkable bank deposits.
   C)   currency in the vault at the bank.
   D)   traveler's checks.

5. According to the aggregate demand curve, when the aggregate price level _____,
   the quantity of _____.
   A)   rises; aggregate output demanded does not change
   B)   falls; aggregate output demanded falls
   C)   rises; aggregate output supplied falls
   D)   rises; aggregate output demanded falls

6. An increase in government transfers is considered to be an example of _____
   because it _____.
   A)   expansionary fiscal policy; shifts the aggregate demand curve to the left, increasing
        aggregate output
   B)   contractionary fiscal policy; shifts the aggregate demand curve to the left,

decreasing aggregate output
- C) expansionary fiscal policy; shifts the aggregate demand curve to the right, increasing aggregate output
- D) contractionary fiscal policy; shifts the aggregate demand curve to the right, decreasing aggregate output

Use the following to answer questions 7-8:

**Table: ABC Bank's Balance Sheet**

| Assets | | Liabilities | |
|---|---|---|---|
| Cash in bank vault | $2 million | Checkable deposits | $100 million |
| Deposits at the Federal Reserve | $13 million | | |
| Loans | $75 million | | |
| Property | $8 million | | |
| Bonds | $2 million | | |

7. (Table: ABC Bank's Balance Sheet) Using the information in ABC Bank's Balance sheet, the bank is holding excess reserve of:
   - A) $15 million.
   - B) $5 million.
   - C) $17 million.
   - D) $25 million.

8. (Table: ABC Bank's Balance Sheet) Refer to the balance sheet. If the minimum reserve ratio for ABC Bank is 10%, then the bank is required to maintain minimum reserves of:
   - A) $7.5 million.
   - B) $10 million.
   - C) $9.5 million.
   - D) $15 million.

9. If the required reserve ratio is 25% and a customer deposits $300 into her checkable deposit, the money supply will _____ if the banking system does NOT hold any excess reserves.
   - A) be unchanged
   - B) increase by $1,200
   - C) increase by $300
   - D) increase by $900

10. In the 1990s, Japan's use of expansionary monetary policy:
    A) proved to be effective in correcting their recessionary problems.
    B) was more successful than their fiscal policy.
    C) was ineffective since short-term interest rates were close to zero.
    D) was especially effective since fiscal policy was contractionary.


11. Currency in the United States today is _____ money.
    A) Intrinsic
    B) Commodity
    C) Fiat
    D) commodity-backed


12. Due to the role of automatic stabilizers and discretionary fiscal policy, the historical record of the United States since 1970 shows that:
    A) the budget tends to move into a surplus during recessions.
    B) the budget tends to remain balanced throughout expansions and recessions.
    C) the budget tends to move into a deficit during recessions.
    D) the budget tends to move into a deficit during expansions.


13. Which of the following is a factor which can not shift the aggregate demand curve?
    A) changes in expectations
    B) changes in wealth
    C) changes in stock market indices
    D) changes in the price level


14. An increase in the short-run aggregate supply curve may be caused by:
    A) a decrease in productivity.
    B) an increase in the price of inputs.
    C) an increase in wages.
    D) an increase in productivity.

Use the following to answer questions 15-16:

**Figure: Fiscal Policy II**
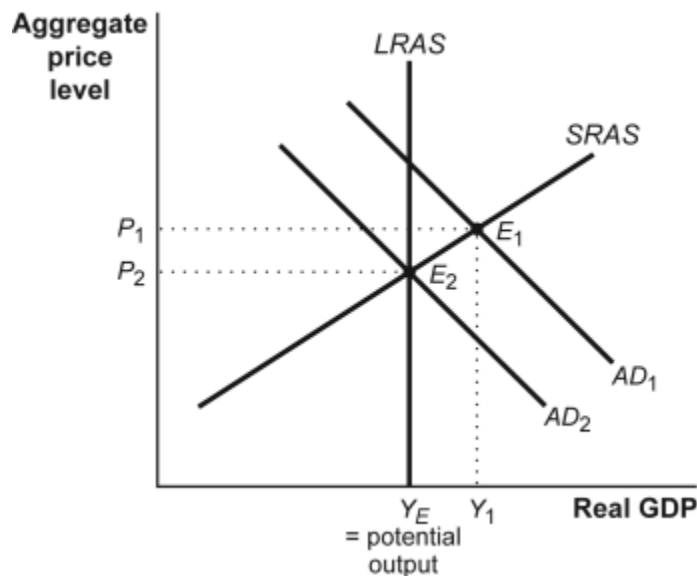


15. (Figure: Fiscal Policy II) Suppose that this economy is in equilibrium at $E_1$. If there is a decrease in government purchases, then:
    A) $AD_2$ will shift to the left, causing a decrease in the price level and a decrease in the real GDP.
    B) $AD_1$ will shift to the right, causing an increase in the price level and an increase in real GDP.
    C) $AD_2$ will shift to the left, causing an increase in the price level and a decrease in real GDP.
    D) $AD_1$ will shift to the left, causing a decrease in the price level and a decrease in real GDP.

16. (Figure: Fiscal Policy II) Suppose that this economy is in equilibrium at $E_1$. If there is an increase in taxes, then:
    A) $AD_2$ will shift to the right, causing a decrease in the price level and an increase in real GDP.
    B) $AD_1$ will shift to the left, causing an increase in the price level and a decrease in real GDP.
    C) $AD_2$ will shift to the right, causing an increase in the price level and an increase in real GDP.
    D) $AD_1$ will shift to the left, causing a decrease in the price level and a decrease in the real GDP.

17. Social insurance programs are:
    A) programs to help unemployed people have a social life.
    B) private insurance policies to protect families from hardships caused by government actions.
    C) government programs intended to protect families against economic hardships.
    D) private insurance policies that cover gaps in government-provided health care.

18. A recessionary gap occurs if:
    A) unemployment is less than the natural rate.
    B) actual real GDP is greater than potential output.
    C) actual real GDP is less than potential output.
    D) actual real GDP is equal to potential output.

19. In the short run, the equilibrium price level and the equilibrium level of total output are determined by the intersection of:
    A) *LRAS* and *SRAS*.
    B) potential output and *LRAS*.
    C) *LRAS* and aggregate demand.
    D) *SRAS* and aggregate demand.

20. Implicit liabilities of a government are:
    A) debt of a country adjusted for the price ratio.
    B) spending promises, like Social Security benefits, that are effectively debt although no bond is associated with the promise.
    C) the ratio of the debt of a country to its GDP.
    D) bonds held by foreigners.

The next questions are from your homework. Answer in the space provided. Please give short answers and use complete sentences. If you do not explain your answer it will be marked wrong, even if you write down a correct number.

1. Show the changes to the T-accounts for the Federal Reserve and for commercial banks when the Federal Reserve sells $30 million in U.S. Treasury bills.

    a. If the public holds a fixed amount of currency (so that all new loans create an equal amount of checkable bank deposits in the banking system) and the minimum reserve ratio is 5%, by how much will checkable bank deposits in the commercial banks change?

    b. By how much will the money supply change?

    c. Show the final changes to the T-account for the commercial banks when the money supply changes by this amount.

2. Suppose that all households hold all their wealth in assets that automatically rise in value when the aggregate price level rises (an example of this is what is called an inflation-indexed bond"—a bond whose interest rate, among other things, changes one-for-one with the inflation rate). What happens to the wealth effect of a change in the aggregate price level as a result of this allocation of assets? What happens to the slope of the aggregate demand curve? Will it still slope downward? Explain.

3. The government's budget surplus in Macroland has risen consistently over the past five years. Two government policy makers disagree as to why this has happened. One argues that a rising budget surplus indicates a growing economy; the other argues that it shows that the government is using contractionary fiscal policy. Can you determine which policy maker is correct? If not, why not?

**Answer Key**

1. B
2. D
3. D
4. C
5. D
6. C
7. B
8. B
9. D
10. C
11. C
12. C
13. D
14. D
15. D
16. D
17. C
18. C
19. D
20. B