ECO202: PRINCIPLES OF MACROECONOMICS
SECOND MIDTERM EXAM
SPRING 2009
Prof. Bill Even

FORM 1

Directions

1. Fill in your scantron with your unique id and form number. Doing this properly is worth the equivalent of 1 question.

2. There are 45 multiple choice questions.

3. Your grade is determined entirely upon the answers listed on your scantron. Your scantron will not be returned so be sure to record your answers on your exam so that you will be able to check your answers once the key is posted.

5. You may use a calculator. Cell phones or other devices that may be used to store text are not allowed.

6. You have until the end of the period to finish the exam**. Additional time may be purchased at a price of 5 percentage points per minute.**

7. Academic dishonesty is a serious offense. In the event I find someone behaving in a dishonest manner, I will ask that the maximum penalty allowed by the university be imposed.

1. The earliest form of money in history was:
a. commodity money
b. fiat money
c. coins
d. none of the above.

2. Suppose that an ounce of gold is worth 4 times as much as an ounce of silver. If there are 4 grains of gold in a $1 gold coin and 15 grains of silver in a $1 silver coin, Gresham's law would predict that:
a. neither gold or silver coins would circulate as money.
b. gold coins would circulate as money, but silver coins would not.
c. silver coins would circulate as money, but gold coins would not.
d. both gold and silver coins would circulate as money.

3. Which of the following is a function of money?
a. unit of account
b. store of value
c. medium of exchange
d. all of the above.

4. Which function of money eliminates the need for a barter economy?
a. unit of account
b. store of value
c. medium of exchange
d. none of the above.

5. Which of the following statements is true?
a. there are 7 members on the Federal Reserve Board of Governors.
b. there are 12 districts in the Federal Reserve System
c. the Federal Reserve was established in 1913.
d. All of the above

6. Which of the following bodies is the main policy-making group in the Federal Reserve System?
a. the Board of Governors.
b. the Federal Open Market Committee.
c. the regional federal reserve banks.
d. the discount committee

To answer the next 2 questions, assume that the banking system starts with the following "base case" balance sheet and that (i) the public initially holds $100 of non-bank cash; (ii) the reserve ratio is 2%; (iii) banks always loan out the maximum amount allowed.

BALANCE SHEET

Reserves	$2,000	Demand Deposits	$100,000
Loans	$90,000		
Govt. bonds	$13,000	Owner's Equity	5,000
	$105,000		$105,000

7. **Start with the base case balance sheet**. If the Fed sells $100 of government bonds to the banking system and the banking system completely adjusts to this change in their balance sheet, the loans will ______ and M1 will _______.

a. decrease $5000, decrease $5000
b. increase $5000, increase $5000
c. increase $1000, increase $1000.
d. none of the above.

8. **Start with the base case balance sheet.** If the Fed increases the reserve ratio from 2% to 4% and the bank system completely adjusts to this change,

a. M1 and loans will decrease $50,000
b. M1 and loans will increase $100,000
c. M1 will decrease $50,000 and loans will decrease $100,000.
d. none of the above.

9. Starting with the base case balance sheet. If the public chooses to withdraw $10 of demand deposits and hold it as nonbank cash, after the bank system completely adjusts to this change:

a. the monetary base will not change.
b. M1 will decrease $490
c. demand deposits will decrease $500
d. all of the above.

10. Holding the coupon rate, maturity value and term of a bond constant, as the price of a bond falls, the yield on the bond:
a. could rise or fall; b. falls. c. rises. d. does not change.

11. Consider a one year bond with a 5% coupon rate and a maturity value of $1000 that sells for $950 today. The yield to maturity on this bond is:
a. 5% b. 10.5% c. 7.2% d. 11.3%

12. Consider a 5 year zero coupon bond with a maturity value of $1000 that sells for $800 today. The annual yield to maturity on this bond is:
a. 5.0% b. 4.6% c. 25.0% d. 17.2%

13. If the Federal Reserve wants to increase the amount of loans available in the banking system to push down interest rates, which combination of policies would be most effective?
a. the Fed sells bonds; raises the reserve ratio, and cuts the discount rate.
b. the Fed buys bonds; cuts the reserve ratio, and raises the discount rate.
c. the Fed buys bonds, cuts the reserve ratio, and cuts the discount rate.
d. the Fed sells bonds, raises the reserve ratio, and raises the discount rate.

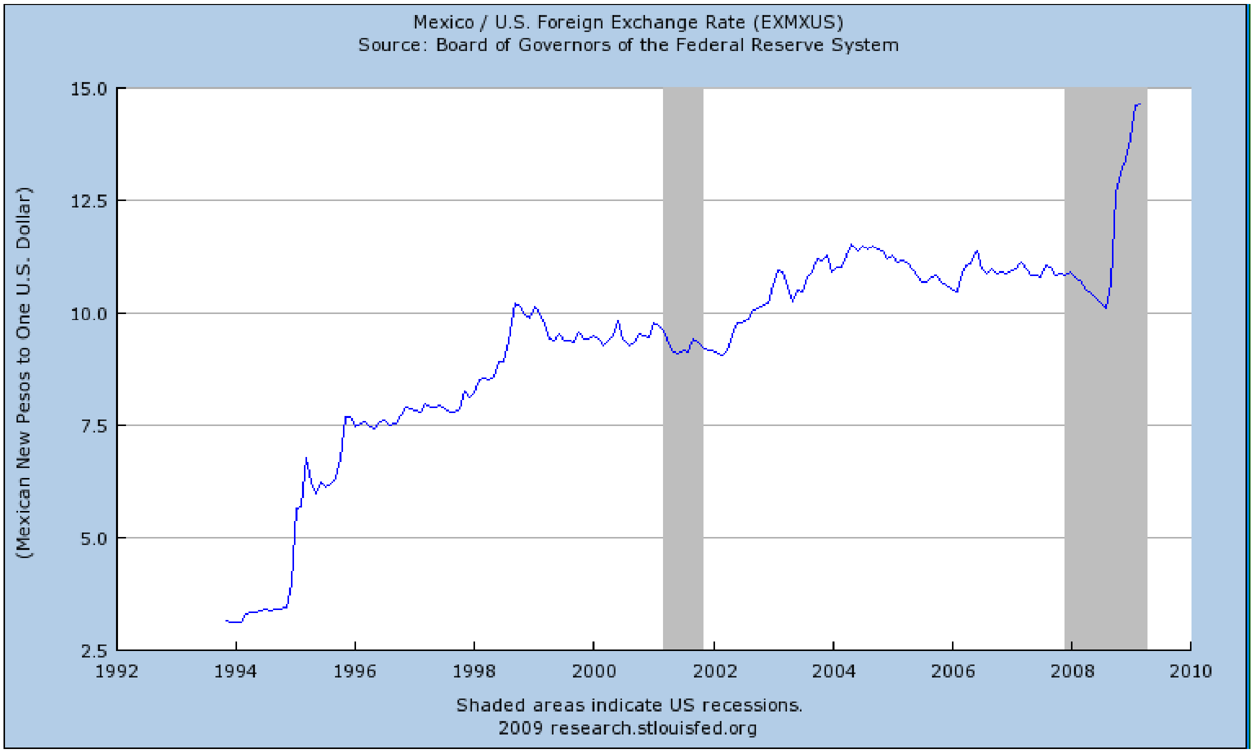
14. If stock prices reflect their fundamental value, then an increase in stock prices could be caused by:
a. an increase in future expected dividend payments.
b. lower interest rates.
c. higher interest rates.
d. either a or b.
e. either a or c.

15. If a corporation is a “growth” company whose profits are expected to rise at an usually rapid pace in the future, we should expect it to have:
a. a high beta coefficient
b. a low beta coefficient
c. a high price-earnings ratio
d. a low price-earnings ratio.

16. Over the past 6 months, the monetary base in the U.S. has:
a. increased by less than 10%
b. increased by more than 50%
c. decreased by less than 10%
d. decreased by more than 50%

17. According to the equation of exchange, higher inflation will occur if:
a. the growth rate in the money supply increases
b. the velocity of money increases
c. the growth rate of real GDP decreases.
d. all of the above

To answer the next 2 questions, refer to the diagram below which shows the number of pesos per dollar since 1994.



18. Based on the information provided, since 1994, the dollar has _____ relative to the Mexican peso.
a. appreciated
b. depreciated

19. Based on the information provided, since 1994, the dollar cost of a 20 peso item

from Mexico ______ and the peso cost of a $20 item from the U.S. ____.
a. rose; fell. b. rose; rose c. fell; rose. d. fell; fell

20. Based on the information provided about the peso/$ exchange rate during 2008, if interest rate parity holds, the interest rate on U.S. bonds would have to be _____ the interest rate on Mexican bonds.
a. above b. below

21. Suppose the dollar is expected to appreciate by 10 percent over the next year relative to the Euro. Also, suppose 1 year government bonds currently offer an interest rate of 12% in the
Euro zone and 3% in the U.S. Based on this information, a wise investor would:
a. be indifferent between U.S. and Euro bonds since the exchange rate fluctuation will offset the higher interest rate in the Euro zone..
b. prefer U.S. bonds over Euro bonds since they will net a 1% higher rate of return.
c. prefer Euor bonds over U.S. bonds since they will net a 19% higher rate of return.
d. none of the above.

22. If the yield curve "inverts" and becomes downward sloping, it is an indication that:
a. interest rates on all government bonds fell.
b. interest rates on all government bonds rose.
c. interest rates on long term government bonds are lower than interest rates on short term government bonds.
d. interest rates on long term government bonds are higher than interest rates on short term government bonds.

23. Based on the supply/demand model for the dollar in foreign currency markets, which of the following would cause the dollar to appreciate relative to the Euro?
a. an increase in European demand for U.S. exports.
b. an increased desire in Europe to invest in the U.S. stock market.
c. an increase in European inflation relative to the U.S.
d. all of the above.

24. Suppose that the rest of the world becomes nervous about investment returns in the U.S. This would likely lead to:
a. a decrease in the supply of dollars and appreciation of the dollar. The depreciation of the dollar would help stimulate U.S. exports and reduce U.S. imports.
b. a decrease in the demand for dollars and depreciation of the dollar. The depreciation of the dollar would help stimulate U.S. exports and reduce U.S. imports.
c. a decrease in the demand for dollars and depreciation of the dollar. The depreciation of the dollar would help stimulate U.S. imports and reduce U.S. exports.
d. a decrease in the supply of dollars and appreciation of the dollar. The depreciation of the dollar would help stimulate U.S. imports and reduce U.S. exports.

25. In class, we discussed the fact that over the past decade China has attempted to keep its currency (the yuan) relatively ______ relative to the dollar in order to ______.
a. strong; stimulate exports to the U.S.
b. strong; reduce exports to the U.S.
c. weak; reduce exports to the U.S.
d. weak; stimulate exports to the U.S.

26. As of 4/5/2008, the exchange rate between the British pound and the Australian dollar was 2.08 Australian dollars per pound. If gold costs 450 pounds in Britain and 1000 Australian dollars in Australia, we should expect to see:
a. people buy gold in Britain and resell it in Australia to take advantage of the price differential. This will gradually increase gold prices in Australia and decrease gold prices in Great Britain.
b. people buy gold in Britain and resell it in Australia to take advantage of the price differential. This will gradually decrease gold prices in Australia and increase gold prices in Great Britain.
c. people buy gold in Australia and resell it in Great Britain to take advantage of the price differential. This will gradually increase gold prices in Australia and decrease gold prices in Great Britain.
d. people buy gold in Australia and resell it in Great Britain to take advantage of the price differential. This will gradually decrease gold prices in Australia and increase gold prices in Great Britain.

27. Suppose that Mexico wants to weaken its currency relative to the dollar. In order to do this, the Mexican central bank should ____ pesos in the foreign exchange market which would ____ the Mexican central banks holdings of dollars.
a. sell; increase.
b. sell; decrease.
c. buy; increase.
d. buy decrease.

28. Suppose that the exchange rate between the dollar and the Euro is fixed at 1 Euro per dollar. If U.S. inflation rises relative to Europes, this will force:
a. the U.S. central bank to buy up excess dollars and reduce their holdings of Euros.
b. the U.S. central bank to sell dollars and increase their holdings of Euros.
c. the U.S. central bank to buy up excess dollars and increase their holdings of Euros.
d. the U.S. central bank to sell dollars and decrease their holdings of Euros.

29. According to the theory of purchasing power parity, the number of pesos per dollar will rise if:
a. Mexico's inflation rate exceeds the U.S. inflation rate.
b. Mexicos' inflation rate is less than the U.S. inflation rate.
c. U.S. interest rates rise relative to Mexican interest rates.
d. both b and c.

30. Which of the following would all lead to a <u>larger capital account surplus</u> in the U.S.?
a. decreased purchases of foreign bonds by U.S. citizens, or increased purchases of U.S. bonds by foreign citizens.
b. decreased purchases of foreign bonds by U.S. citizens, or decreased purchases of U.S. bonds by foreign citizens.
c. increased purchases of foreign bonds by U.S. citizens, or increased purchases of U.S. bonds by foreign citizens.
d. increased purchases of foreign bonds by U.S. citizens, or decreased purchases of U.S. bonds by foreigncitizens.

31. Assuming that the official settlements account has a zero balance, if the U.S. is a net borrower from the rest of the world this year, it will have
a. a current account surplus
b. a capital account surplus
c. a current account deficit
d. both b and c.

32. Over the past decade, the U.S. has regularly experienced a capital account _____ and a current account _____.
a. surplus; surplus.
b. surplus; deficit.
c. deficit; surplus
d. deficit; deficit.

33. Which of the following would lead to a larger current account surplus in the U.S.?
a. an increase in U.S. exports or U.S. imports.
b. an increase in U.S. imports or a decrease in U.S. exports.
c. an increase in U.S. exports or a decrease in U.S. imports.
d. none of the above.

34. Which of the following would simultaneously increase long run aggregate supply and contribute to lower real wages?
a. more immigration is allowed.
b. Social Security is made more generous.
c. the capital stock increases as a result of tax incentives.
d. all of the above.

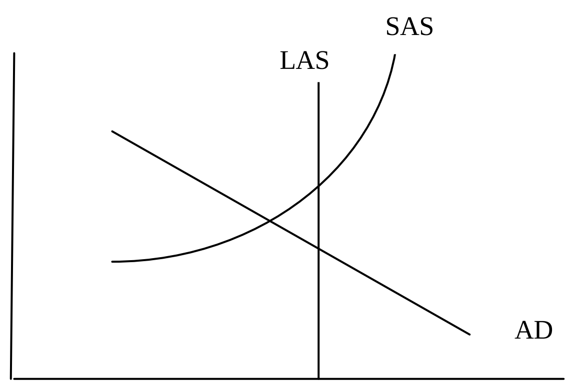
35. Economic growth
a. occurs when LAS shifts right.
b. will lead to lower prices unless AD shifts to the right faster than LAS shifts right.
c. results if labor supply or demand increases, or if the production function shifts upward.
d. all of the above.

36. A decrease in aggregate demand (AD) would be caused by _____ taxes, _____ government spending, or an expectation of _______ future income.
a. higher taxes; decreased; greater.
b. lower taxes; increased; greater.
c. lower taxes; decreased; lower.
d. none of the above.

37. It is estimated that, over the past year, the declining values of stocks have reduced the wealth of American by over $1.2 trillion. If the economy was in a long run equilibrium prior to this decline in wealth, we should expect that, in the short run, this shock to wealth would cause:
a. a decrease in aggregate demand, less employment and higher real wages.
b. a decrease in aggregate demand, less employment and lower real wages.
c. a decrease in aggregate supply, less employment and higher real wages.
d. a decrease in aggregate supply, less employment and lower real wages.

38. The Obama administration has attempted to shorten the current economic recession by:
a.   increasing aggregate demand with a combination of higher taxes and increased government spending.
b.   increasing aggregate supply with a combination of lower taxes and increased government spending.
c.   increasing aggregate demand with a combination of lower taxes and increased government spending.
d.   increasing aggregate supply with a combination of lower taxes and increased government spending.

Consider the diagram below to answer the next 3 questions:

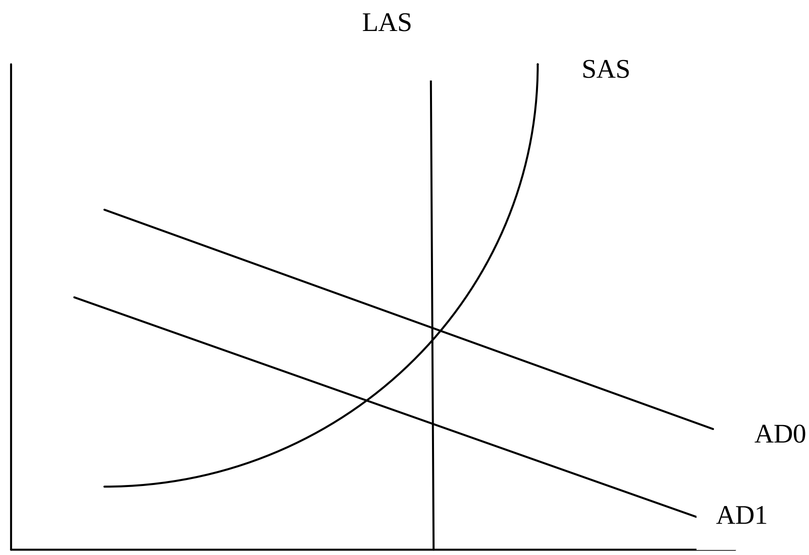


39.   At the short run equilibrium described in the above diagram, the economy is producing (above, below) potential GDP and the unemployment rate is (above, below) the natural rate.
a. above; above.   b. above; below.   c. below; above.   d. below; below

40. At the short run equilibrium described in the above diagram, there is (upward, downward) pressure on real wages because the unemployment rate is (above, below) the natural rate.
a. upward; above.   b. upward; below.
c. downward; above.   d. downward; below

41. Starting at the short run equilibrium described in the above diagram, as the economy moves to the long run equilibrium, it should experience:
a. increases in real wages and prices and decreases in unemployment.
b. decreases in real wages, decreases in prices and decreases in unemployment.
c. increases in real wages and prices and increases in unemployment.
d. decreases in real wages, increases in prices and increases in unemployment.

42. When the price level rises, AD falls
a. because the real value of money decreases and consumption declines
b. because imports increase when the price level rises
c. because interest rates rise, thus reducing consumption in the current period.
d. all of the above.



43. Suppose that the economy starts with AD0 and SAS and there is a shock to the economy shifting AD to AD1. As the economy moves to the new short run equilibrium, the economy will experience ___ prices, ___ unemployment, and _____ real GDP.
a. higher; higher; higher.
b. higher; lower; lower.
c. lower; lower; higher.
d. none of the above.

44. If the economy starts at a long run equilibrium and there is a change in monetary policy that increases the growth in the money supply, **in the long run** this will cause:
a. higher real wages
b. higher employment
c. higher prices.
d. all of the above

45. Which of the following schools of macoeconomic thought would be most supportive of the Obama administration's response to the current recession?
a. classical economist.
b. Keynesian economist
c. Monetarist
d. Marxist.