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 50 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. Suppose interest rate parity holds and one year U.S. government bond yields pay 4% and Australian bonds pay 8%. This must imply that financial markets believe that over the next year:
   a. the U.S. dollar will appreciate by 4% relative to the Australian dollar
   b. the U.S. dollar will appreciate by 2% relative to the Australian dollar
   c. the U.S. dollar will depreciate by 4% relative to the Australian dollar
   d. the U.S. dollar will depreciate by 2% relative to the Australian dollar

To answer the next 2 questions, refer to the diagram below which shows the number of South Korean won per dollar since 2000.

2. Based on the information provided, the number of won per dollar rose from (approximately) 900 to 1400 during 2008. If a person owned S. Korean bonds over this period that paid a yield of 10% in won, what would the approximate yield in U.S. dollars be?
   a. 25%
   b. +10%
   c. -10%
   d. -45%

3. Based on the information provided, between 2000 and 2008, the dollar _____ relative to the S. Korean won and the dollar cost of a 1000 won item from S. Korea _____.
   a. appreciated; rose
   b. appreciated; fell
   c. depreciated; rose
   d. depreciated; fell
4. In class, we discussed the fact that the Chinese argue that they are not “manipulating their currency” and that the source of the trade imbalance with the U.S. is:
   a. the large U.S. government deficit and the low U.S. personal savings rates
   b. low interest rates in the U.S.
   c. trade barriers in the U.S.
   d. all of the above.

5. Suppose that U.S. wants to weaken its currency relative to the won. In order to do this, the U.S. central bank should _____ dollars in the foreign exchange market which would _____ the U.S. money supply.
   a. buy; increase.
   b. buy decrease.
   c. sell; increase.
   d. sell; decrease.

6. Suppose the exchange rate between the yen and won is 4 won per yen. Also, assume the price of an ounce of gold in Japan is 200,000 yen and in Korea the price is 600,000 won. Based on these figures, we should expect to find
   a. people buy gold in Japan and resell it in Korea to take advantage of the price differential. This will gradually increase gold prices in Japan and decrease gold prices in Korea.
   b. people buy gold in Japan and resell it in Korea to take advantage of the price differential. This will gradually increase gold prices in Korea and decrease gold prices in Japan.
   c. people buy gold in Korea and resell it in Japan to take advantage of the price differential. This will gradually increase gold prices in Japan and decrease gold prices in Korea.
   d. people buy gold in Korea and resell it in Japan to take advantage of the price differential. This will gradually increase gold prices in Korea and decrease gold prices in Japan.

7. 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. weak; reduce exports to the U.S.
   b. weak; stimulate exports to the U.S.
   c. strong; stimulate exports to the U.S.
   d. strong; reduce exports to the U.S.
8. An upward sloping yield curve implies that:
   a. interest rates on long term government bonds are lower than interest rates on short term government bonds.
   b. interest rates on long term government bonds are higher than interest rates on short term government bonds.
   c. interest rates on government bonds are falling over time.
   d. interest rates on government bonds are higher than they were previously.

9. Suppose the dollar is expected to depreciate by 4 percent over the next year relative to the Euro. Also, suppose 1 year government bonds currently offer an interest rate of 3% in the Euro zone and 5% 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 lower interest rate in the Euro zone.
   b. prefer U.S. bonds over Euro bonds since they will net a 6% higher rate of return.
   c. prefer Euro bonds over U.S. bonds since they will net a 2% higher rate of return.
   d. none of the above.

10. Suppose initially that the capital and current accounts in the U.S. are in balance. Suppose that investors in the U.S. begin to believe that the stock market in S. Korea will perform incredibly well over the next couple of years. Given the effect on investment flows, imports and exports, we should expect to see the U.S. current account run a _____ and its capital account to run a _____.
   a. Surplus; surplus
   b. Surplus; deficit
   c. Deficit; deficit
   d. Deficit; surplus

11. Suppose that investors in the U.S. begin to believe that the stock market in S. Korea will perform incredibly well over the next couple of years. This would cause the dollar to _____ relative to the Korean won and make U.S. imports from Korea _____ expensive.
   a. depreciate; less
   b. depreciate; more
   c. appreciate; less
   d. appreciate; more

12. Based on the supply/demand model for the dollar in foreign currency markets, which of the following would cause the dollar to depreciate relative to the Japanese yen?
   a. a decrease in Japanese demand for U.S. exports.
   b. a decreased desire in Japan to invest in the U.S. stock market.
   c. a decrease in Japanese prices relative to the U.S.
   d. all of the above.
13. If a country’s central bank takes efforts to weaken its currency, it will result in the central bank ____ holdings of foreign currencies and the country _____ its exports as the currency weakens.
   a. building up; increasing
   b. building up; decreasing
   c. running down; increasing
   d. running down; decreasing

14. Suppose that the exchange rate between the dollar and the Euro is **fixed** at 1 Euro per dollar. If U.S. inflation falls relative to Europe’s, 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.

15. 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.

16. According to the theory of purchasing power parity, the number of Euros per dollar will fall if:
   a. Europe’s inflation rate exceeds the U.S. inflation rate.
   b. Europe’s inflation rate is less than the U.S. inflation rate.
   c. U.S. interest rates rise relative to Europe’s interest rates.
   d. both b and c.

17. In class, we discussed a commodity that is used by *The Economist* to compare the strength of currencies across countries. What is that commodity?
   a. Gold
   b. The Big Mac
   c. Gasoline
   d. Oil
18. Assuming that the official settlements account has a zero balance, when a country is a net lender to the rest of the world, the country will have
a. a current account surplus  
b. a capital account surplus  
c. a current account deficit  
d. both b and c.

19. 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 less generous.  
c. taxes on labor are reduced.  
d. all of the above.

20. 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.

21. 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.

22. Which of the following would all lead to a smaller capital account surplus in the U.S.?  
a. increased purchases of foreign bonds by U.S. citizens, or increased purchases of U.S. bonds by foreign citizens.  
b. increased purchases of foreign bonds by U.S. citizens, or decreased purchases of U.S. bonds by foreign citizens  
c. decreased purchases of foreign bonds by U.S. citizens, or increased purchases of U.S. bonds by foreign citizens.  
d. decreased purchases of foreign bonds by U.S. citizens, or decreased purchases of U.S. bonds by foreign citizens.
23. 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.

24. An increase in aggregate demand (AD) would be caused by _____ taxes, _____ government spending, or an expectation of _______ future income.
   a. lower; decreased; lower.
   b. higher; decreased; greater.
   c. lower; increased; greater.
   d. none of the above.
Consider the diagram below to answer the next 3 questions:

25. 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.

26. 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.

27. 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.
28. Suppose that the economy starts with AD0 and SAS and there is a shock to the economy shifting AD0 to AD1. As the economy moves to the new short run equilibrium, the economy will experience ___ prices, ___ real wages, and _____ real GDP.
   a. higher; higher; higher.
   b. higher; lower; lower.
   c. higher; lower; higher.
   d. none of the above.

29. During the most recent economic recession, which component of the expenditure side of GDP (i.e. AD) took the largest percentage drop?
   a. Consumption
   b. Government purchases of goods and services
   c. Private investment
   d. Net exports

30. Suppose that the economy currently has a recessionary gap. This means that
   a. the economy is producing less than potential GDP
   b. the unemployment rate is below the natural rate of unemployment
   c. real wages will rise as the economy returns to full employment
   d. all of the above.
31. Which of the following statements is false?
   a. there are 7 members on the Federal Reserve Board of Governors.
   b. there are 12 districts in the Federal Reserve System
   c. Alan Greenspan is the chair of the Federal Reserve
   d. All of the above

32. The dollar bills used in the U.S. today are:
   a. commodity money
   b. fiat money
   c. backed by gold
   d. none of the above

33. Suppose that an ounce of gold is worth 10 times as much as an ounce of silver. If there are 4 grains of gold in a $1 gold coin and 30 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. silver coins would circulate as money, but gold coins would not.
   c. gold coins would circulate as money, but silver coins would not.
   d. both gold and silver coins would circulate as money.

34. When GDP in the U.S. is measured in dollars, money is used as
   a. unit of account
   b. store of value
   c. medium of exchange
   d. all of the above.

35. Which of the following functions of money is unique to money and cannot be performed by other assets?
   a. unit of account
   b. store of value
   c. medium of exchange
   d. none of the above.
To answer the next 4 questions, assume that the banking system starts with the following "base case" balance sheet and that (i) the public initially holds $200 of non-bank cash; (ii) the reserve ratio is 4%; (iii) banks always loan out the maximum amount allowed.

**BALANCE SHEET**

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>$2,000</td>
</tr>
<tr>
<td>Loans</td>
<td>$40,000</td>
</tr>
<tr>
<td>Govt. bonds</td>
<td>$13,000</td>
</tr>
<tr>
<td>Demand Deposits</td>
<td>$50,000</td>
</tr>
<tr>
<td>Owner's Equity</td>
<td>$5,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$105,000</strong></td>
</tr>
</tbody>
</table>

36. **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 $100, decrease $100
   b. increase $100, increase $100
   c. increase $2500, increase $2500.
   d. none of the above.

37. **Starting with the base case balance sheet** and the 4% reserve ratio, if the public chooses to deposit $10 of cash and hold it as a demand deposit, after the bank system completely adjusts to this change, the monetary base will _____, M1 will _____, and loans will ______.
   a. not change, rise $250, rise $250
   b. rise $10; rise $250; rise $250
   c. not change; rise $240; rise $240
   d. none of the above.

38. **Start with the base case balance sheet.** If the Fed increases the reserve ratio from 4% to 5% and the bank system completely adjusts to this change, 
   a. M1 and loans will decrease $10,000
   b. M1 and loans will increase $20,000
   c. M1 and loans will decrease $20
   d. none of the above.

39. Based on the information provided, the monetary base is _____ and M1 is _____.
   a. $2000; $50,000
   b. $2200; $50,200
   c. $2200; $40,200
   d. none of the above
40. If the Federal Reserve wants to reduce interest rates, which combination of policies would be most appropriate? The Fed should _____ bonds, ____ the discount rate, and ______ the required reserve ratio.
   a. buy; lower; lower.
   b. sell; lower; lower.
   c. buy; raise; raise.
   d. sell; raise; lower.

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

42. In the money supply / money demand model, if the interest rate is above the equilibrium interest rate, the market adjusts by:
   a. people buying bonds which drives bond prices up and interest rates down
   b. people buying bonds which drives bond prices and interest rates down
   c. people selling bonds which drives bond prices up and interest rates down
   d. people selling bonds which drives bond prices and interest rates down

43. If stock prices reflect their fundamental value, lower stock prices would be caused by
   a. higher interest rates or lower expected dividend payments
   b. higher interest rates or higher expected dividend payments
   c. lower interest rates or lower expected dividend payments
   d. lower interest rates or higher expected dividend payments

44. Consider a one year bond with a 8% coupon rate and a maturity value of $1000 that sells for $1020 today. The yield to maturity on this bond is:
   a. 6.1%  
   b. 5.9% 
   c. 5.7%  
   d. 8.1%

45. Consider a 15 year zero coupon bond with a maturity value of $1000 that sells for $700 today. The annual yield to maturity on this bond is:
   a. 2.0%        
   b. 2.4%        
   c. 2.9%        
   d. 3.5%
46. A major change in policy implemented by the Federal Reserve over the past two years was:
   a. Their purchase of mortgage backed securities
   b. The addition of two additional district banks
   c. The take-over of FDIC
   d. All of the above.

47. If the efficient markets hypothesis is true, then if you read in the paper that Apple corporation has made a technological breakthrough that will lead to a very profitable new laptop computer,
   a. you should buy Apple stock because its price will rise in the future
   b. you should buy Apple stock because its dividends will rise in the future
   c. you shouldn’t be anxious to buy or sell Apple stock, because the price will already reflect this new information.
   d. both a and b

48. If the stock market is declining in value, the stocks that are likely to generate the greatest losses will be those with:
   a. A high beta coefficient
   b. A low beta coefficient
   c. A high price earnings ratio
   d. A high alpha coefficient

49. If a corporation is in a declining industry where profits are expected to diminish over time, 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.

50. According to the equation of exchange, the rate of inflation equals:
   a. the growth rate in the money supply + growth rate in velocity – growth rate in real GDP
   b. the growth rate in the money supply + growth rate in velocity – growth rate in nominal GDP
   c. the growth rate in the money supply + growth rate in velocity + growth rate in real GDP
   d. the growth rate in the money supply + growth rate in velocity + growth rate in nominal GDP