Midterm 2

CODE OF HONOR PLEDGE:

I will not give or receive aid on this examination. I understand that if I am aware of cheating on this exam, I have an obligation to inform the instructor. I also understand that the instructor will follow the University of Notre Dame Academic Code of Honor if he/she detects an act of academic dishonesty.

SIGNATURE: _____

DATE: _____

Instructions:

1. Please use scantron to complete Part I

2. Use number 2 or softer pencil for the scantron

3. Be concise in Part II but do not omit crucial steps to increase a chance of getting a partial credit for an incorrect final answer

4. Record your answers for Part II in the designated boxed areas

Part I	/ 60
Part II	/ 40
TOTAL	/100

Part I: Multiple Choice (60 points, 60 minutes)

*Don't forget to record your answers on the scantron sheet.*

1. Money market mutual funds invest in

    A. residential mortgages.
    B. long term government securities.
    C. commercial real estate.
    D. highly liquid assets.

2. The slope of the consumption function is

    A. negative.
    B. 1.
    C. less than 1.
    D. greater than 1.

3. To prevent cost-push inflation

    A. there must not be an excess demand for money.
    B. interest rates must not rise.
    C. there must not be an increase in government purchases.
    D. the Fed must not let the quantity of money rise persistently.

4. Which of the following would shift the aggregate demand curve leftward year after year?

    A. a one-time tax cut
    B. inflation
    C. a one-time increase in government expenditures on goods and services
    D. negative growth in the quantity of money

5. When workers and employers correctly anticipate an increase in inflation caused by an increase in aggregate demand,

    A. workers will underestimate the real wage rate.
    B. workers will overestimate the real wage rate.
    C. unemployment will be at the natural rate.
    D. there will be no unemployment.

6. In the United States, of the following decades inflation was highest during the _____,

    A. 1960s
    B. 1990s
    C. 2000s
    D. 1970s

7. You observe that unplanned inventories are increasing. You predict that there will be _____.

    A. a recession
    B. a business cycle
    C. an expansion
    D. a trough

8. Actual aggregate expenditure is

    A. always equal to real GDP.
    B. only equal to real GDP at the equilibrium level of aggregate planned expenditure.
    C. never greater than real GDP but can be less than real GDP.
    D. never less than real GDP but can be greater than real GDP.

9. Suppose that a shock causes the aggregate demand curve to shift rightward. If the Fed does nothing,

   A. eventually the short run aggregate supply curve will shift leftward and there will be continued inflation.
   B. the economy will experience a temporary reduction in employment but will eventually return to full employment.
   C. output initially will exceed potential GDP, but the economy will return to potential GDP with a higher price level.
   D. the short run aggregate supply curve will not shift leftward and there will be continued inflation.

10. By itself, an increase in the price of oil shifts the

    A. short-run aggregate supply curve leftward and does not shift the aggregate demand curve.
    B. aggregate demand curve leftward and does not shift the short- run aggregate supply curve.
    C. aggregate demand curve rightward and does not shift the short-run aggregate supply curve.
    D. short-run aggregate supply curve rightward and does not shift the aggregate demand curve.

11. Which of the figures best shows the start of a demand-pull inflation?

    A. Figure A
   B. Figure B
    C. Figure C
    D. Figure D
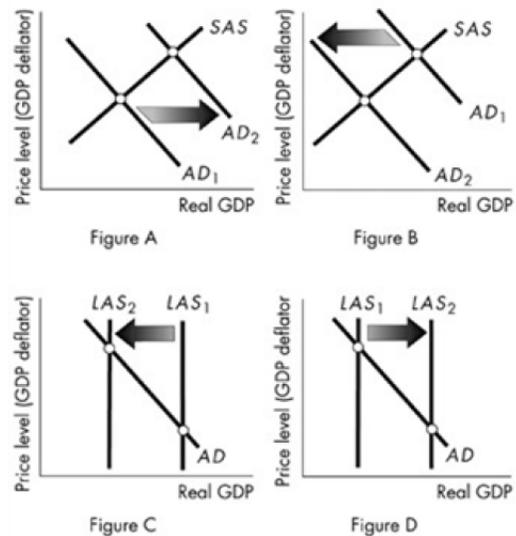
12. According to the intertemporal substitution effect, a higher price level

    A. makes it less costly for people to buy houses and cars.
    B. lowers the costs of building new plants and equipment.
    C. decreases the quantity of real GDP demanded.
    D. increases the quantity of real GDP demanded.

13. Which of the following is NOT an economic benefit of depository institutions?

    A. They pool risk
    B. They create liquidity
    C. They borrow long and lend short
    D. They reduce the cost of monitoring borrowers

14. Stagflation is the combination of

    A. inflation and increasing real GDP.
    B. inflation and recession.
    C. deflation with increasing real GDP.
    D. deflation and recession.

15. Of the following, the riskiest assets held by commercial banks are

    A. U.S. government Treasury bills.
    B. reserves.

C. commercial loans.

D. U.S. government bonds.

16. In the figure, the economy is initially at point B. If the government decreases transfer payments, there is

    A. a shift to AD_2.

    B. a movement to point A.

    C. a movement to point C.

    D. a shift to AD_1.
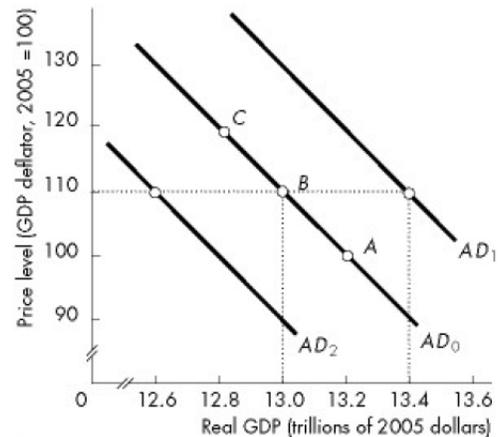
17. The size of the multiplier

    A. decreases in the longer run.

    B. stays constant in the longer run.

    C. increases in the longer run.

    D. is unaffected by the amount of time that elapses.

18. The quantity of real GDP demanded equals $12.2 trillion when the GDP deflator is 90. If the GDP deflator rises to 95, the quantity of real GDP demanded equals

    A. less than $12.2 trillion.

    B. $12.2 trillion.

    C. more than $12.2 trillion.

    D. more information is needed to determine if the quantity of real GDP demanded increases, decreases, or does not change.

19. If the Fed responds to an initial increase in aggregate demand by increasing the quantity of money

    A. money wages will fall to reduce unemployment.

    B. there is the risk of continued inflation.

    C. real GDP will begin to decrease more rapidly than if the quantity of money had remained constant.

    D. there will be no inflationary gap.

20. Given the list of assets below, which is the most liquid?

    A. $500 worth of General Motors bonds

    B. a one-ounce gold coin

    C. a $500 traveler's check

    D. $500 worth of General Motors common stock

21. Which of the following is part of M2?

    A. credit cards

    B. currency held inside a bank

    C. checks

    D. None of these are part of M1 or M2.

22. In April 2008 the price of oil was approximately $130 per barrel; in April 2015, it was approximately $40 per barrel. This change in the price of oil could have started

    A. both a cost-push and a demand-pull inflation.

    B. a cost-push inflation.

C. a demand-pull inflation.

D. None of the above answers are correct.

23. Cigarettes served as money in some POW camps during World War II. Given this fact, we would expect to observe

A. prices of other goods expressed in terms of cigarettes.

B. people usually resorting to barter rather than using cigarettes as money.

C. no one ever smoking a cigarette.

D. only government-issued cigarettes being accepted as money.

24. A rational expectation is

A. always an incorrect forecast.

B. not necessarily correct but is the best available forecast.

C. a correct forecast but it might not be the best available forecast.

D. necessarily correct because it is the best available forecast.

25. Which of the following does NOT shift the short-run aggregate supply curve?

A. a change in the money wage rate

B. technological progress

C. a reduction in the price of a raw material

D. a change in the price level

26. The data in the table indicate that autonomous expenditure is

A. $3.0 trillion.

B. $0.3 trillion.

C. $4.8 trillion.

D. indeterminate from the information given.

Real GDP (trillions of 2005 dollars)	Aggregate expenditure (trillions of 2005 dollars)
0	0.3
1.0	1.2
2.0	2.1
3.0	3.0
4.0	3.9
5.0	4.8

27. Which of the following is NOT a potential start of a demand-pull inflation?

A. an increase in the money supply

B. an increase in exports

C. an increase in government expenditure

D. an increase in taxes

28. If real disposable income increases by $1500, consumption expenditures will

A. increase by more than $1500.

B. increase by less than $1500.

C. decrease by less than $1500.

D. stay constant.

29. A one-time rise in the price level can turn into a demand-pull inflation when _____.

A. taxes consistently increase

B. the money wage rate continues to increase

C. the quantity of money persistently increases

D. the quantity of money persistently decreases

30. Which of the following does NOT occur as the economy moves from an expansion to a recession?

A. The change in planned spending exceeds the change in real GDP.

B. An initial decrease in autonomous spending is the trigger that creates the business cycle turning

point.

C. The multiplier process reinforces any decrease in spending and pushes the economy into recession.

D. Incomes fall during recessions as firms cut production in response to unplanned increases in inventories.

Part II. Problems (40 points, 15 minutes)

1. (15 points, 5 minutes) The economy is currently in the long-run equilibrium. Imagine that, suddenly, potential GDP grows. Using the AS-AD model, provide a graphic illustration and explain how this economy can end up with inflation or deflation (relatively to the original price level) in the new long-run equilibrium (do both inflation and deflation cases). *Make sure to label everything relevant.*
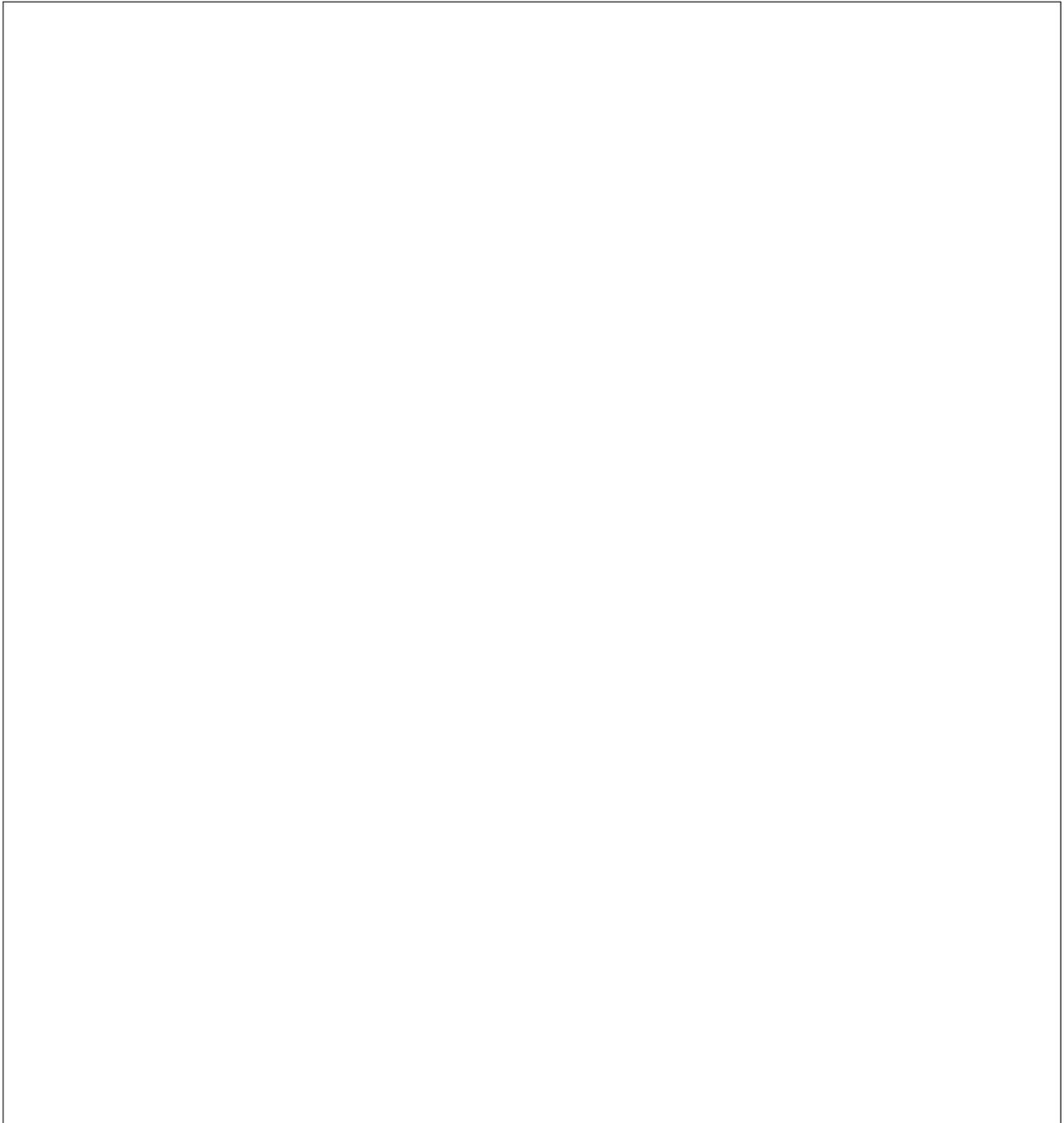
2. (25 points, 10 minutes) The economy is currently in equilibrium. The aggregate planned expenditure function is:

$$APE = C + I + G + E - IM$$

where E is exports, which are part of the autonomous expenditure, and IM are imports. Imports depend on the level of GDP and are described by the following import function:

$$IM = k \cdot GDP$$

The consumption function is:

$$C = a + b \cdot YD$$

where YD is disposable income. Taxes are autonomous and a, b, and k are constants.

a) (15 points) Derive the expression for the expenditure multiplier (denote multiplier by M).

b) (10 points) If $a = 3$, $b = 0.4$ and $k = 0.2$, what will the change in the equilibrium GDP be if exports decrease by 15?

Extra Pages for Plots

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