

Final Exam

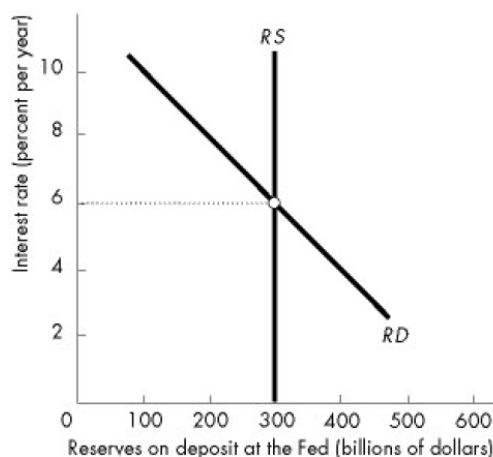
1. For movements along the long-run aggregate supply curve
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 - (b) the prices of goods and services change while the prices of productive resources remains constant
 - (c) the price level changes while the money wage rate remains constant
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2. A major characteristic of structural unemployment that differentiates it from frictional unemployment is that structural unemployment
 - (a) exists only during a recession
 - (b) usually lasts longer than frictional unemployment
 - (c) is a short-term problem
 - (d) exists in an expansion whereas there is no frictional unemployment in an expansion
3. During the financial crisis of 2008-2009, the Fed was concerned about
 - (a) the bubble that was forcing asset prices higher
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 - (c) providing the banking system with enough liquidity
 - (d) the public's rush to deposit its currency into banks
4. When autonomous expenditure changes, the horizontal distance by which the aggregate demand curve shifts
 - (a) depends on the size of the wealth effect
 - (b) is increased by the existence of automatic stabilizers
 - (c) is determined by the inverse of the multiplier
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5. In the short run, the Federal Reserve faces a tradeoff between
 - (a) economic growth and employment
 - (b) inflation and real GDP growth
 - (c) interest rates and unemployment
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6. Which of the following are included in the expenditure approach to calculating GDP?
- (a) Government expenditure; consumption expenditure; net exports
 - (b) Net exports of goods and services; net interest; net domestic income at factor cost
 - (c) Consumption expenditure; net exports of goods and services; depreciation
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7. Suppose prices are quoted in dollars and transactions are conducted in pesos. The peso serves as a
- (a) medium of exchange
 - (b) unit of account
 - (c) store of value
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8. If the demand for reserves is unchanged, an increase in the quantity of reserves will
- (a) not affect the federal funds rate
 - (b) increase the federal funds rate
 - (c) lower the federal funds rate
 - (d) None of the above answers is correct
9. In the United States, the CPI basket consists of items that _____. _____ has the greatest weight in the CPI basket
- (a) An average urban household buys; Housing
 - (b) A middle-income household buys; Food and beverages
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 - (d) All households buy; Transportation
10. An aggregate production function:
- (a) shows the relationship between a country's output and its price level
 - (b) shows various quantities of two goods that can be produced at a given cost
 - (c) shows various combinations of labor and capital that can be used to produce a particular good
 - (d) shows the relationship between a country's GDP and its factors of production
11. If the real interest rate increases,
- (a) there will be a movement up along the demand for loanable funds curve
 - (b) the supply of loanable funds curve will shift rightward
 - (c) the nominal interest rate will also increase
 - (d) the demand for loanable funds curve will shift rightward

12. The use of discretionary fiscal policy to end a recession is limited because
- (a) in the real world, taxes are not induced
 - (b) potential GDP changes too rapidly
 - (c) the legislative process is slow
 - (d) the real-world multiplier is too small to have an impact on real GDP
13. The formal and informal rules governing the organization of a society on the whole, including its laws and regulations, are referred to as:
- (a) organizational structure
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14. In response to the financial crisis of 2007 and the ensuing recession, the Fed announced three rounds of “quantitative easing”, where the Fed purchased billions of dollars of securities. What impact would quantitative easing have on the monetary base?
- (a) While the monetary base would change, it is impossible to predict how
 - (b) The monetary base would increase
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15. On the Fed’s balance sheet, assets include
- (a) reserves of depository institutions and mortgage-backed securities
 - (b) U.S. government securities and mortgage-backed securities
 - (c) currency and mortgage-backed securities
 - (d) currency and reserves of depository institutions
16. When the Federal Reserve lends reserves to depository institutions, it charges them interest. That interest rate is called the
- (a) prime rate
 - (b) federal funds rate
 - (c) loan rate
 - (d) discount window rate
17. Suppose that the equilibrium real interest rate is 2 percent per year, inflation is 2.5 percent and the output gap is 1 percent. Using the Taylor rule, what is the federal funds rate?
- (a) 5.25 percent
 - (b) 3.5 percent
 - (c) 3 percent
 - (d) 5.5 percent

18. Suppose that the tax rate on interest income is 50 percent, the real interest rate is 3 percent, and the inflation rate is 4 percent. In this case, the real after-tax interest rate is equal to
- (a) 3.0 percent
 - (b) -0.5 percent
 - (c) 4 percent
 - (d) 3.5 percent
19. In 2012, the federal funds rate was _____ and consequently banks had a _____ incentive to hold excess reserves
- (a) high; small
 - (b) low; large
 - (c) low; small
 - (d) high; large
20. If real GDP per person doubles in 20 years, then the annual growth rate of real GDP per person is _____ percent a year.
- (a) 28.5
 - (b) 14
 - (c) 3.5
 - (d) 14.3
21. Country X and Country Y have identical aggregate production functions. The amount of capital stock available to each country is also equal. However, Country X currently uses less labor than Country Y. A one unit increase in labor supply will lead to _____ in output in Country X than in Country Y.
- (a) a smaller increase
 - (b) a smaller decrease
 - (c) a larger increase
 - (d) a larger decrease
22. The Laffer curve shows that increasing _____ increases _____ when _____ low.
- (a) potential GDP; tax revenue; tax revenue is
 - (b) tax rates; tax revenue; tax rates are
 - (c) tax revenue; potential GDP; tax revenue is
 - (d) None of the above answers is correct

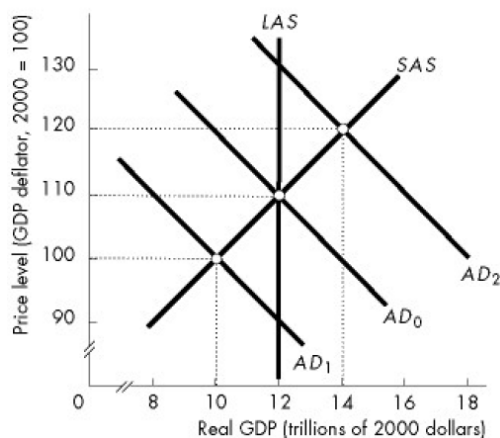
23. Suppose the Consumer Price Index is 143.6. What does that number mean?
- (a) Prices rose 143.6 percent over the reference base period, on average
 - (b) Prices rose 43.6 percent over the reference base period, on average
 - (c) On average, goods cost \$143.60
 - (d) On average, goods cost \$243.60
24. Goods that are produced this year, stored in inventories, and sold to consumers next year
- (a) count in both this year's and next year's GDP
 - (b) count in next year's GDP
 - (c) count in this year's GDP
 - (d) are not counted as a part of GDP
25. The figure shows the market for bank reserves in Futureland.



If the Bank of Futureland undertakes an open market sale of government securities that changes the quantity of reserves by \$100 billion, then the federal funds rate will _____.

- (a) remain at 6 percent a year
 - (b) fall to 4 percent a year
 - (c) rise to 8 percent a year
 - (d) None of the above answers is correct
26. Suppose the working age population in Tiny Town is 100 people. If 25 of these people are not in the labor force, the _____ equals _____.
- (a) labor force; 25 percent
 - (b) unemployment rate; 25 percent
 - (c) labor force; 75 percent
 - (d) labor force; 75 people

27. In an economy, 42 million people are in the labor force, 38 million are employed, and 47 million are of working age. How many people are not in the labor force?
- 4 million
 - 9 million
 - 5 million
 - 19 percent
28. If the basket of goods and services used to calculate the CPI cost \$200 in the reference base period and \$450 in a later year, the CPI for the latter year equals
- 325
 - 225
 - 200
 - 450
29. In the figure, the economy experiences an increase in aggregate demand so that the aggregate demand curve shifts from AD_0 to AD_2 .



If the Fed wants to offset this change, it would _____

- purchase government securities on the open market
 - sell government securities on the open market
 - raise taxes
 - increase government expenditures
30. An economy has a consumption function of $C = 15 + 0.7Y$, investment of 8, government expenditure of 12, exports of 20, and an import function of $M = 0.2Y$. If government expenditure increases by 10, what is the increase in equilibrium expenditure?
- 5
 - 20
 - 14.3
 - 33.3

31. In January 2013, Tim's Gyms, Inc. owned machines valued at \$1 million. During the year, the market value of the equipment fell by 30 percent. During 2013, Tim spent \$200,000 on new machines. During 2013, Tim's net investment totalled
- (a) -\$100,000
 - (b) -\$300,000
 - (c) \$200,000
 - (d) \$1 million
32. If you use \$500 of currency to purchase a saving deposit,
- (a) M1 is unchanged, but M2 increases
 - (b) M1 decreases and M2 increases
 - (c) M1 and M2 both increase
 - (d) M1 decreases, but M2 is unchanged
33. Suppose that you took out a \$1000 loan in January and had to pay \$75 in annual interest. During the year, inflation was 6 percent. Which of the following statements is correct?
- (a) The nominal interest rate is 7.5 percent and the real interest rate is 13.5 percent
 - (b) The real interest rate is 6 percent and the nominal interest rate is 7.5 percent
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 - (d) The nominal interest rate is 7.5 percent and the real interest rate is 1.5 percent

34. Use the information below to answer questions 34–37.

Consider an economy with a bank, a firm, and a central bank. The firm sells hotdogs from vending machines. The vending machines are the only input that the firm uses. In January of 2015 the firm had one hundred vending machines, each valued at \$3,000. The balance sheets for 01/01/2015 are:

The Fed:

Assets, in thousands		Liabilities, in thousands	
<i>Item</i>	<i>value</i>	<i>Item</i>	<i>value</i>
T-bills	\$300	Bank's deposits	\$200
Bank loan	\$100	Currency	\$200
Total assets	\$400	Total liabilities	\$400

The bank:

Assets, in thousands		Liabilities, in thousands	
<i>Item</i>	<i>value</i>	<i>Item</i>	<i>value</i>
T-bills	\$150	Firm's deposits	\$200
Business loan	\$400	Loan from the Fed	\$100
Deposits at the Fed	\$200		
Cash	\$100		
Total assets	\$850	Total liabilities	\$300

The firm:

Assets, in thousands		Liabilities, in thousands	
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Deposits at the bank	\$200	Business loan	\$400
Cash	\$100		
Vending machines	\$300		
Total assets	\$600	Total liabilities	\$400

If the required reserve ratio is 15%, what are the bank's excess reserves?

- (a) \$255,000
- (b) \$270,000
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35. The Fed estimates that in order to go back to full employment economy, the economy needs twice as many vending machines. To double the number of the machines, the firm needs an additional business loan from the bank in the amount of 400 thousand dollars. How much money does the Fed need to inject in the economy so the bank can provide such a loan to the firm?
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38. Which of the following is considered a depository institution?
- I. the U.S. Treasury
 - II. a commercial bank like Citibank
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- (a) I only
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39. Liquidity trap is
- (a) a situation when banks don't have any liquid assets
 - (b) a situation when the Fed runs out of money
 - (c) a situation when the fed funds rate is near zero
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40. Consider an economy with the GDP per capita equal to \$1,000. What would GDP per capita be in 200 years if this economy grew at a constant rate of 2% per year?
- (a) \$5,000
 - (b) \$204,000
 - (c) \$52,485
 - (d) \$20,000

Extra credit

Read the paragraph below and answer questions 41–45. Numbers in the blank spaces correspond to the question numbers. Use the scantron to record your choices.

___41___, is the main character in the movie. He is trying to deal with the financial crisis that had started in 2008. ___42___ was an investment bank that was largely affected by the subprime mortgage crisis. Its CEO was reluctant to declare bankruptcy because he was sure that the U.S. Treasury would bail his company out, similarly to what the Treasury had done for ___43___. The solution offered by Hank Paulson was to purchase ___44___ from the big investment banks in order to increase their available reserves. In order to do so, Paulson and Geitner tried to arrange mergers between the biggest ___45___ banks, because without the act of The Congress, ___45___ banks cannot use the Fed's discount window. This was not successful, and the Fed continued with Troubled Asset Relief Program. The latter helped to increase the supply of credit in the economy, but the Fed could not dictate to banks what they should do with the available funds.

41. (a) Ben Bernanke, the Chairman of the Federal Reserve Board of Governors
(b) Hank Paulson, U.S. Treasury Secretary
(c) Dick Fuld, CEO of Lehman Brothers
(d) Tim Geitner, the President of the New York Fed
42. (a) Bear Stearns
(b) Bank of America
(c) Lehman Brothers
(d) Goldman Sachs
43. (a) Bear Stearns
(b) Bank of America
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44. (a) mortgage-backed securities
(b) U.S. Treasury bills
(c) Foreign government securities
(d) U.S. Treasury notes
45. (a) investment and commercial; commercial
(b) investment and commercial; investment
(c) foreign and domestic; foreign
(d) investment and saving; saving

Final Exam Answer Key

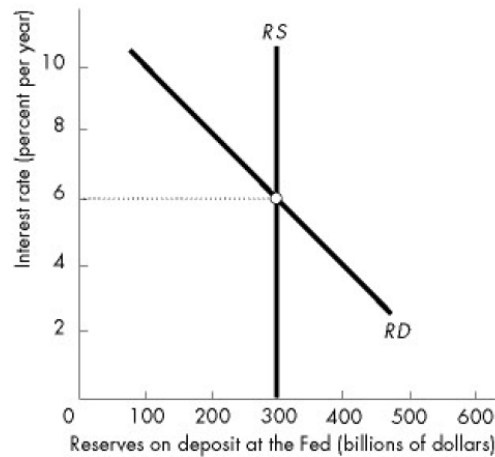
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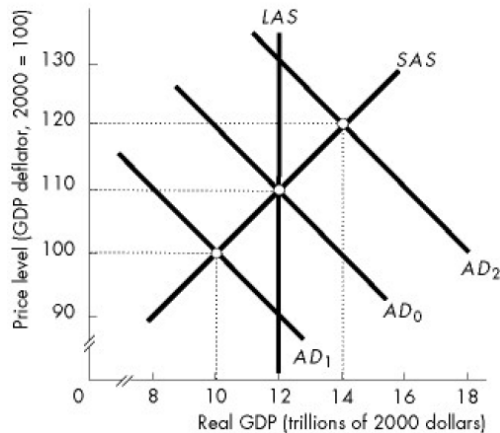
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<i>Item</i>	<i>value</i>	<i>Item</i>	<i>value</i>
T-bills	\$300	Bank's deposits	\$200
Bank loan	\$100	Currency	\$200
Total assets	\$400	Total liabilities	\$400

The bank:

Assets, in thousands		Liabilities, in thousands	
<i>Item</i>	<i>value</i>	<i>Item</i>	<i>value</i>
T-bills	\$150	Firm's deposits	\$200
Business loan	\$400	Loan from the Fed	\$100
Deposits at the Fed	\$200		
Cash	\$100		
Total assets	\$850	Total liabilities	\$300

The firm:

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Cash	\$100		
Vending machines	\$300		
Total assets	\$600	Total liabilities	\$400

If the required reserve ratio is 15%, what are the bank's excess reserves?

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Extra credit

Read the paragraph below and answer questions 41–45. Numbers in the blank spaces correspond to the question numbers. Use the scantron to record your choices.

___41___, is the main character in the movie. He is trying to deal with the financial crisis that had started in 2008. ___42___ was an investment bank that was largely affected by the subprime mortgage crisis. Its CEO was reluctant to declare bankruptcy because he was sure that the U.S. Treasury would bail his company out, similarly to what the Treasury had done for ___43___. The solution offered by Hank Paulson was to purchase ___44___ from the big investment banks in order to increase their available reserves. In order to do so, Paulson and Geitner tried to arrange mergers between the biggest ___45___ banks, because without the act of The Congress, ___45___ banks cannot use the Fed's discount window. This was not successful, and the Fed continued with Troubled Asset Relief Program. The latter helped to increase the supply of credit in the economy, but the Fed could not dictate to banks what they should do with the available funds.

41. (a) Ben Bernanke, the Chairman of the Federal Reserve Board of Governors
 (b) Hank Paulson, U.S. Treasury Secretary
(c) Dick Fuld, CEO of Lehman Brothers
(d) Tim Geitner, the President of the New York Fed
42. (a) Bear Stearns
(b) Bank of America
 (c) Lehman Brothers
(d) Goldman Sachs
43.
 (a) Bear Stearns
(b) Bank of America
(c) Lehman Brothers
(d) Goldman Sachs
44.
 (a) mortgage-backed securities
(b) U.S. Treasury bills
(c) Foreign government securities
(d) U.S. Treasury notes
45. (a) investment and commercial; commercial
 (b) investment and commercial; investment
(c) foreign and domestic; foreign
(d) investment and saving; saving