

Name \_\_\_\_\_

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Section Number \_\_\_\_\_

**MULTIPLE CHOICE.** Choose the one alternative that best completes the statement or answers the question.

- 1) If monetary policy can influence \_\_\_\_\_ prices and conditions in \_\_\_\_\_ markets, then it can affect spending through channels other than the traditional interest-rate channel. 1) \_\_\_\_\_  
A) commodity; credit                      B) commodity; labor  
C) asset; credit                              D) asset; labor
- 2) Suppose the U.S. economy is operating at potential output. A negative supply shock that is accommodated by an open market purchase by the Federal Reserve will cause \_\_\_\_\_ in real GDP and \_\_\_\_\_ in the aggregate price level in the long run, everything else held constant. 2) \_\_\_\_\_  
A) no change; a decrease                      B) a decrease; a decrease  
C) no change; an increase                      D) an increase; an increase
- 3) Suppose the economy is producing at the natural rate of output. An open market purchase of bonds by the Fed will cause \_\_\_\_\_ in real GDP and \_\_\_\_\_ in the aggregate price level in the long run, everything else held constant. 3) \_\_\_\_\_  
A) no change; an increase                      B) no change; a decrease  
C) an increase; an increase                      D) a decrease; a decrease
- 4) Despite an expansionary monetary policy, an economy experiences a recession. Everything else held constant, the recession could occur in spite of the rightward shift of the LM curve if 4) \_\_\_\_\_  
A) there is an investment boom.  
B) consumer confidence decreases sharply.  
C) taxes are cut.  
D) the money supply increases.
- 5) In the ISLM framework a contractionary fiscal policy causes aggregate output to \_\_\_\_\_ and the interest rate to \_\_\_\_\_, everything else held constant. 5) \_\_\_\_\_  
A) decrease; increase                      B) increase; increase  
C) increase; decrease                      D) decrease; decrease
- 6) When the exchange rate for the Mexican peso changes from 9 pesos to the U.S. dollar to 10 pesos to the U.S. dollar, then the Mexican peso has \_\_\_\_\_ and the U.S. dollar has \_\_\_\_\_. 6) \_\_\_\_\_  
A) appreciated; depreciated                      B) depreciated; appreciated  
C) depreciated; depreciated                      D) appreciated; appreciated

- 7) Everything else held constant, which of the following does not cause aggregate demand to increase? 7) \_\_\_\_\_
- A) An increase in net exports.
  - B) An increase in government spending.
  - C) An increase in taxes.
  - D) An increase in consumer optimism.
- 8) Everything else held constant, a decrease in the cost of production \_\_\_\_\_ aggregate \_\_\_\_\_. 8) \_\_\_\_\_
- A) increases; supply
  - B) decreases; demand
  - C) increases; demand
  - D) decreases; supply
- 9) Analysis of the transmission mechanisms of monetary policy provides four basic lessons for a central bank's conduct of monetary policy. These lessons include: 9) \_\_\_\_\_
- A) Monetary policy can be highly effective in reviving a weak economy even if short-term interest rates are already near zero.
  - B) Other asset prices beside those on short-term debt instruments do not contain important information about the stance of monetary policy because they are not important elements in various monetary policy transmission mechanisms.
  - C) Avoiding fluctuations in the level of unemployment is an important objective of monetary policy, thus providing a rationale for interest-rate stability as the primary long-run goal for monetary policy.
  - D) Rising interest rates indicate a tightening of monetary policy, whereas falling interest rates indicate an easing of monetary policy.
- 10) If output adjusts \_\_\_\_\_ to the natural rate level, and if time lags between policy actions and changes in aggregate output are relatively \_\_\_\_\_, then the case for activist policy is weakened. 10) \_\_\_\_\_
- A) quickly; short
  - B) slowly; short
  - C) slowly; long
  - D) quickly; long
- 11) Aggregate demand and supply analysis indicates that negative supply shocks 11) \_\_\_\_\_
- A) decrease the price level, but cannot decrease the inflation rate.
  - B) decrease both the price level and the inflation rate.
  - C) increase the price level, but cannot increase the inflation rate.
  - D) increase both the price level and the inflation rate.
- 12) Which of the following increases aggregate supply in the short-run, everything else held constant? 12) \_\_\_\_\_
- A) A technological improvement that increases worker productivity.
  - B) An increase in the price of crude oil.
  - C) Expectations of a higher aggregate price level.
  - D) A successful wage push by workers.

- 13) If the U.S. dollar appreciates from 1.25 Swiss franc per U.S. dollar to 1.5 francs per dollar, then the franc depreciates from \_\_\_\_\_ U.S. dollars per franc to \_\_\_\_\_ U.S. dollars per franc. 13) \_\_\_\_\_  
A) 0.33; 0.50      B) 0.67; 0.80      C) 0.80; 0.67      D) 0.50; 0.33
- 14) Due to asymmetric information in credit markets, monetary policy may affect economic activity through the balance sheet channel, where an increase in the money supply 14) \_\_\_\_\_  
A) raises the level of bank reserves, deposits, and bank loans, thereby raising spending by those individuals who do not have access to credit markets.  
B) raises firms' net worth, decreasing adverse selection and moral hazard problems, thus increasing banks' willingness to lend to finance investment spending.  
C) raises stock prices, lowering the cost of new capital relative to firms' market value, thus increasing investment spending.  
D) lowers the value of the dollar, increasing net exports and aggregate demand.
- 15) The aggregate demand curve slopes downward because a decrease in the price level means \_\_\_\_\_ in the real money supply and therefore a \_\_\_\_\_ level of real spending. 15) \_\_\_\_\_  
A) an increase; higher      B) a decrease; lower  
C) a decrease; higher      D) an increase; lower
- 16) The proposition that inflation is the result of a high rate of money growth is 16) \_\_\_\_\_  
A) supported by evidence from inflationary episodes throughout the world.  
B) largely a political fabrication designed to make the Fed a scapegoat for poor fiscal policy.  
C) held only by sociologists and is no longer believed by economists.  
D) not supported by evidence from the German hyperinflation.
- 17) Suppose that the economy is at the natural rate of output. In the absence of accommodating policy and everything else held constant, the net result of a negative supply shock is that 17) \_\_\_\_\_  
A) the economy returns to full employment at a higher price level.  
B) aggregate output increases above the natural rate level, but only temporarily.  
C) the economy returns to full employment at a lower price level.  
D) the economy returns to full employment at the initial price level.
- 18) Suppose nominal GDP is equal to \$200 trillion and the money supply equals \$50 trillion. In this case, the velocity of money is equal to \_\_\_\_\_ 18) \_\_\_\_\_  
A) 2      B) 4      C) 5      D) 1

- 19) By analyzing aggregate demand through its component parts, we can conclude that, everything else held constant, a decline in the price level causes \_\_\_\_\_
- A) an increase in the real money supply, a decline in interest rates, an increase in investment spending, and an increase in aggregate output demand.
  - B) a decline in the real money supply, a decline in interest rates, an increase in investment spending, and an increase in aggregate output demand.
  - C) an increase in the real money supply, an increase in interest rates, a decline in investment spending, and a decline in aggregate output demand.
  - D) a decline in the real money supply, an increase in interest rates, a decline in investment spending, and a decline in aggregate output demand.
- 20) In the Keynesian cross diagram, a decline in autonomous consumer expenditure causes the aggregate demand function to shift down, the equilibrium level of aggregate output to \_\_\_\_\_, and the IS curve to shift to the \_\_\_\_\_, everything else held constant.
- A) fall; left      B) rise; right      C) rise; left      D) fall; right
- 21) This method of financing government spending is frequently called printing money because high-powered money (the monetary base) is created in the process. \_\_\_\_\_
- A) Financing government spending by selling bonds to the public, which pays for the bonds with checks.
  - B) The finance of government spending through a Treasury sale of bonds that are then purchased by the Fed.
  - C) Financing government spending with taxes.
  - D) Financing government spending by selling bonds to the public, which pays for the bonds with currency.
- 22) A decrease in the quantity of money supplied shifts the money supply curve to the \_\_\_\_\_, and the equilibrium interest rate \_\_\_\_\_, everything else held constant. \_\_\_\_\_
- A) left; falls      B) right; falls  
C) right; rises      D) left; rises
- 23) If policymakers set a target for unemployment that is too low because it is less than the natural rate of unemployment, this can set the stage for a higher rate of money growth and \_\_\_\_\_
- A) demand-push inflation.
  - B) demand-pull inflation.
  - C) cost-pull inflation.
  - D) cost-push inflation.
- 24) The combination of a successful wage push by workers and the government's commitment to high employment leads to \_\_\_\_\_
- A) demand-pull inflation.
  - B) cost-push inflation.
  - C) supply-shock inflation.
  - D) supply-side inflation.

- 25) The German hyperinflation of the 1920s supports the proposition that excessive monetary growth causes inflation and not the other way around since the increase in monetary growth appears to have been  
A) unintentional. B) intentional.  
C) endogenous. D) exogenous. 25) \_\_\_\_\_
- 26) A reduction of aggregate demand may raise the natural rate of unemployment above the full employment level, meaning that the self-correcting mechanism will only be able to return the economy to the natural rate level of output and unemployment—not to the full employment levels. Such a view is consistent with  
A) hysteresis. B) Keynesianism.  
C) monetarism. D) real business cycle theory. 26) \_\_\_\_\_
- 27) Although the U.S. has a well-developed government bond market and has experienced relatively small budget deficits relative to GDP, deficits can be inflationary if  
A) the Fed refuses to purchase government bonds.  
B) deficits put upward pressure on interest rates, and the Fed attempts to keep interest rates from rising.  
C) the world's supply of gold expands because of new gold discoveries.  
D) deficits put upward pressure on interest rates, and fiscal authorities raise taxes in an attempt to keep interest rates from rising. 27) \_\_\_\_\_
- 28) Milton Friedman's proposition concerning the cause of inflation implies a simple solution to the inflation problem:  
A) reduce the growth rate of the money supply.  
B) limit the ability of fiscal policymakers to bring pressure to bear on the monetary authority.  
C) limit the number of terms that politicians are allowed to serve.  
D) reduce government budget deficits. 28) \_\_\_\_\_
- 29) The theory of PPP suggests that if one country's price level rises relative to another's, its currency should  
A) float. B) appreciate.  
C) depreciate. D) do none of the above. 29) \_\_\_\_\_
- 30) Nonactivists contend that a policy of shifting the aggregate demand curve will be costly because it produces more volatility in both the price level and output. Thus they favor  
A) discretionary policy.  
B) demand-management policy.  
C) a policy of variable money supply growth.  
D) a constant-money-growth-rate rule. 30) \_\_\_\_\_

- 31) Workers will have greater incentives to push for higher wages when government policymakers place greater concern on \_\_\_\_\_ than \_\_\_\_\_ and are thus \_\_\_\_\_ likely to adopt accommodative policies. 31) \_\_\_\_\_
- A) unemployment; inflation; less
  - B) inflation; unemployment; less
  - C) unemployment; inflation; more
  - D) inflation; unemployment; more
- 32) In the long run, a rise in a country's price level (relative to the foreign price level) causes its currency to \_\_\_\_\_, while a fall in the country's relative price level causes its currency to \_\_\_\_\_. 32) \_\_\_\_\_
- A) depreciate; depreciate
  - B) depreciate; appreciate
  - C) appreciate; appreciate
  - D) appreciate; depreciate
- 33) Methods of financing government spending are described by an expression called the government budget constraint, which states the following: 33) \_\_\_\_\_
- A) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the Fed.
  - B) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the Treasury.
  - C) the government budget deficit must equal the sum of the change in the monetary base and the change in government bonds held by the public.
  - D) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the public.
- 34) The short-run aggregate supply curve is upward sloping because in the short run, costs of many factors that go into producing goods and services are \_\_\_\_\_, meaning that the price for a unit of output will \_\_\_\_\_ relative to input prices and the profit per unit will rise. 34) \_\_\_\_\_
- A) flexible; fall
  - B) flexible; rise
  - C) fixed; rise
  - D) fixed; fall
- 35) According to aggregate demand and supply analysis of inflation and with everything else held constant, a continually increasing money supply causes 35) \_\_\_\_\_
- A) aggregate demand to increase along a stationary aggregate supply curve, leading to continually increasing aggregate output and prices.
  - B) aggregate demand to increase continually as aggregate supply decreases continually, leading to higher and higher price levels.
  - C) aggregate demand to decrease continually as aggregate supply increases continually, leading to higher and higher price levels.
  - D) aggregate supply to decrease along a stationary aggregate demand curve, leading to continually contracting aggregate output and prices.

- 36) The monetary transmission mechanism that links monetary policy to GDP through real interest rates and investment spending is called the \_\_\_\_\_
- A) traditional interest-rate channel.  
B) cash flow channel.  
C) wealth effects.  
D) Tobins' q theory.
- 37) As bonds become a riskier asset, the demand for money \_\_\_\_\_ and, all else constant, the equilibrium interest rate \_\_\_\_\_.
- A) falls; falls  
B) falls; rises  
C) rises; rises  
D) rises; falls
- 38) According to the household liquidity effect, an expansionary monetary policy causes a \_\_\_\_\_ in the value of households' financial assets, causing consumer durable expenditure to \_\_\_\_\_.
- A) decline; fall  
B) decline; rise  
C) rise; fall  
D) rise; rise
- 39) According to economists who believe in Ricardian Equivalence, when the government runs a deficit and issues bonds,
- A) the public works less to avoid these future taxes, causing the demand for bonds to decrease.  
B) the Fed must sell bonds to keep the interest rate from rising.  
C) the Fed must purchase bonds to keep the interest rate from rising.  
D) the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds.
- 40) Methods of financing government spending are described by an expression called the government budget constraint, which states the following:
- A)  $\text{DEFICIT} = (G - T) = \Delta \text{MB} - \Delta \text{BONDS}$ .  
B)  $\text{DEFICIT} = (G - T) = \Delta \text{MB} / \Delta \text{BONDS}$ .  
C)  $\text{DEFICIT} = (G - T) = \Delta \text{BONDS} - \Delta \text{MB}$ .  
D)  $\text{DEFICIT} = (G - T) = \Delta \text{MB} + \Delta \text{BONDS}$ .
- 41) Suppose the economy is producing at the natural rate of output. Assuming a fixed natural rate of output and everything else held constant, the development of a new, more productive technology will cause \_\_\_\_\_ in the unemployment rate and \_\_\_\_\_ the aggregate price level in the long run.
- A) an increase; an increase  
B) a decrease; an increase  
C) no change; no change  
D) a decrease; a decrease
- 42) Franco Modigliani has found that an expansionary monetary policy can cause stock market prices to \_\_\_\_\_ and consumption to \_\_\_\_\_.
- A) decrease; increase  
B) increase; decrease  
C) decrease; decrease  
D) increase; increase
- 43) An increase in the money supply shifts the LM curve to the right, causing the interest rate to \_\_\_\_\_ and output to \_\_\_\_\_, everything else held constant.
- A) rise; fall  
B) rise; rise  
C) fall; fall  
D) fall; rise

- 44) If workers demand and receive higher real wages (a successful wage push), the cost of production \_\_\_\_\_ and the short-run aggregate supply curve shifts \_\_\_\_\_.  
 A) falls; leftward  
 B) rises; rightward  
 C) rises; leftward  
 D) falls; rightward
- 45) A reduction in government spending causes the equilibrium level of aggregate output to \_\_\_\_\_ at any given interest rate and shifts the \_\_\_\_\_ curve to the \_\_\_\_\_, everything else held constant.  
 A) fall; IS; left  
 B) rise; LM; right  
 C) rise; IS; right  
 D) fall; LM; left
- 46) Financing government spending by selling bonds to the public, which pays for the bonds with currency,  
 A) leads to a permanent decline in the monetary base.  
 B) has no net effect on the monetary base.  
 C) leads to a permanent increase in the monetary base.  
 D) leads to a temporary increase in the monetary base.
- 47) If the deficit is financed by selling bonds to the \_\_\_\_\_, the money supply will \_\_\_\_\_, causing aggregate demand to \_\_\_\_\_.  
 A) central bank; rise; increase  
 B) public; rise; increase  
 C) central bank; fall; decrease  
 D) public; fall; decrease
- 48) A rise in autonomous planned investment spending causes the equilibrium level of aggregate output to \_\_\_\_\_ and shifts the \_\_\_\_\_ curve to the \_\_\_\_\_, everything else held constant.  
 A) rise; LM; right  
 B) rise; IS; right  
 C) fall; LM; left  
 D) fall; IS; left
- 49) With a 10 percent interest rate on dollar deposits, and an expected appreciation of 7 percent over the coming year, the expected return on dollar deposits in terms of the foreign currency is  
 A) 3 percent.  
 B) 10 percent.  
 C) 13.5 percent.  
 D) 17 percent.
- 50) According to Tobin's q theory, when equity prices are low the market price of existing capital is \_\_\_\_\_ relative to new capital, so expenditure on fixed investment is \_\_\_\_\_.  
 A) cheap; high  
 B) dear ; low  
 C) cheap; low  
 D) dear; high



Spring 2010 (Final exam): Solution key

1 C  
2 C  
3 A  
4 B  
5 D  
6 B  
7 C  
8 A  
9 A  
10 D  
11 C  
12 A  
13 C  
14 B  
15 A  
16 A  
17 D  
18 B  
19 A  
20 A  
21 B  
22 D  
23 B  
24 B  
25 D

26 A  
27 B  
28 A  
29 C  
30 D  
31 C  
32 B  
33 C  
34 C  
35 B  
36 A  
37 C  
38 D  
39 D  
40 D  
41 C  
42 D  
43 D  
44 C  
45 A  
46 B  
47 A  
48 B  
49 D  
50 C