

PART I (50 points)

Instructions:

Enter your answer to each of the 20 multiple-choice questions in the **bubble sheet** provided on page 12 below. Each correct answer is worth **2.5 points**. **Note that no deduction will be made for incorrect answers.** Table cells left blank will receive zero points. **Do NOT guess your answers! Manage your time properly!**

1. Suppose a Canadian firm imports \$5,000 worth of Frisbees from China and sells them for \$10,000. What will be the impact of this transaction on Canada's GDP?
 - A) Canada's GDP will increase by \$15,000.
 - B) Canada's GDP will decrease \$15,000.
 - C) Canada's GDP will increase by \$5,000.
 - D) Canada's GDP will decrease by \$5,000.
 - E) Canada's GDP will not be affected.

2. China is being accused by Donald Trump of setting the value for its domestic currency too low. All else equal, which one of the following statements might describe the impact of an undervalued domestic currency on the Chinese economy?
 - A) The prices of imported goods would be artificially low for Chinese consumers.
 - B) Inflation pressure would tend to decrease in the Chinese economy.
 - C) The Chinese money supply would tend to decrease.
 - D) China will experience greater capital inflows.
 - E) None of the above is correct.

3. Consider the IS-LM framework in a fixed-price-level model of the economy. If investment spending is very sensitive to the interest rate, which one of the following statements is correct?
 - A) The LM curve will be relatively steep and the IS curve relatively flat.
 - B) The LM curve will be relatively flat.
 - C) The IS curve will be relatively flat.
 - D) Both the IS and the LM curve will be relatively flat.
 - E) None of the above is correct.

Use this space for rough work.

4. Consider the IS-LM framework in a fixed-price-level model of the economy. If the demand for money is very sensitive to the interest rate, which one of the following statements is correct?
- A) The LM curve will be relatively flat and the IS curve relatively steep.
 - B) The LM curve will be relatively flat.
 - C) The IS curve will be relatively flat.
 - D) Both the IS and the LM curve will be relatively flat.
 - E) None of the above is correct.
5. Consider the IS-LM framework in a fixed-price-level model of the economy. If there is at the same time a tax cut and an open market sale of bonds, which one of the following statements best describes the likely outcome?
- A) The interest rate will increase but output could increase or decrease.
 - B) Output will increase but the rate of interest could increase or decrease.
 - C) The interest rate will increase while output will decrease.
 - D) Both output and the interest rate will increase.
 - E) None of the above is correct.
6. Suppose most people had anticipated that inflation would increase by 10% in the coming year because the Central Bank would increase the money supply by 10%. Instead, the Central Bank increases the money supply by only 5%. In the short run, this would cause actual output to be _____ full-employment output and prices to increase by _____ 5%.
- A) above; less than.
 - B) below; more than.
 - C) above; more than.
 - D) below; less than.
 - E) None of the above is correct.
7. Consider an open economy with a fixed price level, fixed exchange rate, and imperfect capital mobility. The introduction of a stylish new line of Hondas, which makes more consumers prefer imported cars over domestic cars, will lead to
- A) a rise in income, the money supply, and net exports.
 - B) no change in income or net exports but a rise in the money supply.
 - C) a fall in income but no change in net exports and no change in the money supply.
 - D) no change in income but a fall in net exports and a rise in the money supply.
 - E) a fall in income, net exports, and the money supply.

Use this space for rough work.

8. Consider a small open economy with flexible exchange rates and fixed price level. In 2016, national saving was \$85 billion, investment was \$112 billion, and private saving was \$114 billion. Therefore, in 2016 the government budget deficit was ___ and the current account balance was ___.
- A) \$2 billion; -\$35 billion.
 - B) -\$2 billion; \$35 billion.
 - C) \$29 billion; -\$27 billion.
 - D) -\$29 billion; \$27 billion.
 - E) None of the above is correct.
9. Which of the following best describes the likely impact of the collapse of oil prices in Canada?
- A) The non-tradable sector will expand.
 - B) The non-energy tradable sector will contract.
 - C) The CPI will increase in the short run.
 - D) The energy sector will expand.
 - E) The production of oil substitutes will expand.
10. Suppose the domestic interest rate is 5 percent, the international interest rate is 8 percent, and the risk premium is 0 percent. If the exchange rate is expected to depreciate by 2 percent, which one of the following would describe the likely short-run outcome?
- A) The flow of capital will not be affected.
 - B) There will be a decrease in the net inflow of capital.
 - C) There will be an increase in the net inflow of capital.
 - D) There will be an increase in the net outflow of capital.
 - E) There will be a decrease in the net outflow of capital.
11. Consider an economy currently in equilibrium. The public likes to hold 20% of their money holdings (M) in cash (CU_P). Banks like to hold 15% of public's deposits (D) as reserves (R) and currently hold \$30 as reserves. Which of the following statements is correct?
- A) The quantity of cash held by the public (Cu_p) is \$50.
 - B) The money multiplier (mm) is approximately 2.75.
 - C) The money supply is \$200.
 - D) The monetary base (B) is \$75.
 - E) None of the above is correct.

Use this space for rough work.

12. Suppose you observe that in the long-run real GDP increases while the price level remains unchanged. If prices are flexible, this observation can only be the result of
- A) an increase in aggregate demand.
 - B) an increase in potential (i.e., full-employment) GDP with no change in aggregate demand.
 - C) a simultaneous increase in aggregate demand and potential GDP.
 - D) an increase in aggregate demand accompanied by a reduction in potential GDP.
 - E) a rise in aggregate supply.
13. The less flexible money wages and prices are,
- A) the steeper the AS curve will be.
 - B) the steeper the LM curve will be.
 - C) the flatter the IS curve will be.
 - D) the flatter the Phillips curve will be.
 - E) the flatter the AD curve will be.
14. Consider the flexible-wage model where the production function is $Y = 20 N^{1/2}$ and the supply of labour is $W = N^{1/2} / 10$. What is the equation for the AS curve in this economy?
- A) $Y = 200 P^{1/2}$
 - B) $Y = 200 P^{-1/2}$
 - C) $Y = 200 P$
 - D) $Y = 200$
 - E) None of the above.
15. Consider the AD-AS model where the AS curve is given by $P = P_{-1} + \lambda(Y - Y^*)$. If a negative demand shock occurs, which one of the following statements best describes the likely outcome in the short run?
- A) The nominal wage will decrease but the real wage will remain unchanged.
 - B) The nominal wage will decrease and the real wage will increase.
 - C) The nominal wage will remain unchanged but the real wage will decrease.
 - D) Both the nominal and the real wage will increase.
 - E) Both the nominal and the real wage will decrease.
16. Consider the Classical AD-AS model where workers do not suffer from “money illusion”. If workers decide to supply less labour at all levels of real wages, which of the following statements is correct?
- A) The real wage will increase while the price level will stay constant.
 - B) The real wage will increase and the price level will decrease.
 - C) The real wage will decrease and the price level will increase.
 - D) Both the real wage and the price level will decrease.
 - E) Both the real wage and the price level will increase.

Use this space for rough work.

17. In the flexible-wage model where workers suffer from money illusion, which of the following statements is true in the short run?
- A) A decrease in the price level shifts the short-run AD curve to the right.
 - B) The real wage is always higher than the nominal wage.
 - C) If the real wage decreases, the quantity supplied of labour decreases.
 - D) If the nominal wage decreases, the quantity supplied of labour decreases.
 - E) Both C) and D) are correct.
18. Consider the AD-AS model of a closed economy with flexible money wages. Assume workers suffer from money illusion in the short run. In this model, what will be the **short-run** impact of contractionary monetary policy?
- A) The level of income, the rate of inflation, and the real rate of interest will all fall.
 - B) The level of income and the rate of inflation will both fall but the real rate of interest will rise.
 - C) The rate of inflation and the real rate of interest will both rise but the level of income will not change.
 - D) The rate of inflation will fall but the level of income and the real rate of interest will both remain unchanged.
 - E) None of the above is correct.
19. Consider the AD-AS model of a closed economy with flexible money wages. Assume workers suffer from money illusion in the short run. In this model, what will be the **long-run** impact of contractionary monetary policy?
- A) The rate of inflation will fall but the level of income and the real rate of interest will both remain unchanged.
 - B) The level of income, the rate of inflation, and the real rate of interest will all fall.
 - C) The level of income and the rate of inflation will both fall but the real rate of interest will not change.
 - D) The rate of inflation and the real rate of interest will both rise but the level of income will not change.
 - E) None of the above is correct.
20. The marginal product of labour for New Age Nirvana is $MP_N = 400 - 2N$, where N is labour units. The price of output is \$3 per unit. What is the quantity demanded of labour if the nominal wage is \$30?
- A) 170.
 - B) 185.
 - C) 190.
 - D) 195.
 - E) None of the above is correct.

Use this space for rough work.

PART II (50 marks)

Instructions: Answer **all** five questions in the space provided. Each question is of equal value. It is best to write in **PENCIL** and use an **ERASER** as needed. This way you can make sure to fit your final answer in the appropriate space.

- 1. Critically comment on the following statement:** *“When the U.S. economy goes into recession, it is better for Canada to be on a fixed exchange rate system rather than on a flexible exchange rate system.”* Show your answer with the help of a diagram and **explain** the economics. Consider the fixed-price-level model of an open economy with perfect capital mobility.



2. A 2010 *Globe and Mail* editorial argued that the Federal Reserve's policy of quantitative easing was in fact a devaluation by another name. What may have been the likely impact of the Fed's quantitative easing on an emerging market economy? **Show your answer with the help of a diagram and explain the economics. Consider an open economy with a fixed-price level, flexible exchange rates, and imperfect capital mobility. Assume this emerging market economy is initially at full employment.**



3. **Critically comment on the following statement:** *“If a technological breakthrough causes a significant drop in the price of energy, then the price level, the level of national income, and the level of real wages will all decrease in the long run.”* (Show your answer with the help of a diagram and explain the economics. Consider the AD-AS model where the short-run aggregate supply (SAS) curve is $P = P_{-1} [1 + \lambda(Y - Y^*)]$ and assume the economy was initially in long-run equilibrium.)



4. Consider an economy with flexible-price-level, fixed exchange rate, and no capital mobility. Assume this economy is currently at full employment and with a large trade surplus. The government of this country is resisting international pressure to revalue its currency and has decided instead to let the market guide the economy to a simultaneous situation of internal and external balance. With the help of a diagram and using the AD-AS-NX model developed in class, explain the process of adjustment as determined by the market mechanism.



5. What was – according to Adair Turner and others – the fundamental cause of the financial crisis that resulted in the Great Recession? Why were mainstream economists unable to foresee the coming of the crisis? According to Turner, what could be done to prevent a similar crisis in the future? And according to Guttenberg and Werner?