Department of Economics
University of Toronto

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ECO 209Y
MACROECONOMIC THEORY AND POLICY

Term Test # 3

LAST NAME ______________________________________

FIRST NAME _____________________________________

STUDENT NUMBER ________________________________

Indicate your section of the course:

☐ **Monday, 2-4 – L0101** ☐ **Tuesday, 2-4 – L0201**

☐ **Wednesday, 2-4 – L0301** ☐ **Thursday, 2-4 – L0401**

INSTRUCTIONS:

1. The total time for this test is 1 hour and 45 minutes.
2. Aids allowed: a simple, non-programmable calculator.
3. Use pen instead of pencil.

DO NOT WRITE IN THIS SPACE

Part I	_________/35	Part II	1.	_________/10
			2.	_________/10
			3.	_________/10
TOTAL	_________/75		4.	_________/10

PART I (35 marks)

Instructions:

- Enter your answer to each question in the table below. Table cells left blank will receive a zero mark for that question.
- Each correct answer is worth 2.5 marks. ***Note that no deductions will be made for incorrect answers.***

1	2	3	4	5	6	7
8	**9**	**10**	**11**	**12**	**13**	**14**

1. China is being accused by Western countries of setting the value for its domestic currency too low. All else equal, which one of the following statements might describe the impact of this alleged currency undervaluation on the Chinese economy?

- **A)** The prices of imported goods would be artificially low for Chinese consumers.
- **B)** The Chinese money supply would tend to increase.
- **C)** Inflationary pressure would tend to decrease in the Chinese economy.
- **D)** China will experience greater net capital inflows.
- **E)** None of the above is correct.

2. Consider an open economy with a fixed price-level, flexible exchange rates, and perfect capital mobility. An increase in government expenditure will cause

- **A)** output and interest rate to increase, and domestic currency to depreciate.
- **B)** output and interest rate to increase, and domestic currency to appreciate.
- **C)** domestic currency to appreciate, while output and interest rate will remain unchanged.
- **D)** domestic currency to appreciate, output to rise, but interest rate will remain unchanged.
- **E)** domestic currency to appreciate, interest rate to rise, but output will remain unchanged.

Use this space for rough work.

3. Consider an open economy with a fixed-price level, flexible exchange rates, and perfect capital mobility. If autonomous exports increased, which one of the following would be true in the new equilibrium?
- **A)** The rate of interest would increase.
- **B)** The balance in the capital account would improve.
- **C)** The balance in the current account would improve.
- **D)** Both the rate of interest and the level of income would remain unchanged.
- **E)** None of the above is true.

4. Consider an open economy with a fixed-price level, flexible exchange rates, and imperfect capital mobility. An increase in the money supply will cause
- **A)** output and exchange rate to increase, and interest rate to decrease.
- **B)** output, interest rate, and exchange rate to increase.
- **C)** output and interest rate to increase, and exchange rate to decrease.
- **D)** output and exchange rate to decrease, and interest rate to increase.
- **E)** output to decrease, and exchange rate and interest rate to increase.

5. Consider an open economy with a fixed-price level, flexible exchange rates, and perfect capital mobility. A lower tariff on imports will
- **A)** raise exports but leave imports unchanged.
- **B)** raise imports but lower exports.
- **C)** raise both imports and exports.
- **D)** lower both exports and imports.
- **E)** raise imports but leave exports unchanged.

6. Suppose there was monetary equilibrium in the economy. If now the banks' desired reserve ratio increased while the public's desired currency-deposit ratio remained unchanged, which one of the following would be true in the new monetary equilibrium?
- **A)** The monetary base would decrease.
- **B)** The money supply would rise.
- **C)** The money multiplier would increase.
- **D)** Banks will give more loans to the public.
- **E)** Currency in hand of the public would decrease.

Use this space for rough work.

7. The monetary base is $20 billion, currency held by commercial banks is equal to $3 billion, commercial banks' deposits at the Central Bank are $7 billion, and the public's deposits at the commercial banks are $70 billion. The money multiplier is equal to

- **A)** 2.5.
- **B)** 4.0.
- **C)** 3.0.
- **D)** 5.0.
- **E)** none of the above.

8. Suppose there was monetary equilibrium in the economy. If now the public's desired currency-deposit ratio increased while the banks' desired reserve ratio remained unchanged, which one of the following would be true in the new monetary equilibrium?

- **A)** The monetary base would decrease.
- **B)** Banks' reserves would decrease.
- **C)** The money supply would rise.
- **D)** The money multiplier would increase.
- **E)** Banks will give more loans to the public.

9. Suppose that households and firms always keep 20 percent of their money holdings in the form currency and that the money multiplier is 3. If the government borrows $100 million from the central bank to finance a new expenditure, the demand deposits of the public will

- **A)** remain unchanged.
- **B)** increase by $20.
- **C)** increase by $300.
- **D)** increase by $240.
- **E)** increase by $100.

10. Consider an economy currently in monetary equilibrium. The money supply is $80 billion. The public likes to hold one-quarter of their money holdings in cash (CU_P). Banks like to hold one-sixth of their customers' deposits (D) as reserves (R). Which of the following statements is correct?

- **A)** The money multiplier (mm) is 2.5
- **B)** The reserves of the banks (R) are $10 billion.
- **C)** The public's desired currency-deposit ratio (cu) is 0.25.
- **D)** The monetary base (B) is $30 billion.
- **E)** Both B) and D) are correct.

Use this space for rough work.

11. All else equal, if people decide to hold less currency,

- **A)** the money multiplier will remain unchanged but money supply will fall.
- **B)** the monetary base and the money supply will both increase.
- **C)** the money multiplier will decrease and the money supply will contract.
- **D)** the money multiplier will increase and the money supply will expand.
- **E)** the money multiplier will decrease but the monetary base will not change.

12. If the money multiplier is 2 and the Bank of Canada buys $1.5 million of bonds on the open market at the same time that it sells $1 million of foreign exchange, then the M1 money supply will

- **A)** increase by $1 million.
- **B)** increase by $0.5 million.
- **C)** fall by $5 million.
- **D)** increase by $2.5 million.
- **E)** fall by $1 million.

13. An increase in government spending will have the greatest expansionary impact on equilibrium income when it is financed by:

- **A)** selling bonds to the general public.
- **B)** selling bonds to the central bank.
- **C)** selling bonds to the commercial banks.
- **D)** increasing sales taxes.
- **E)** increasing income taxes on the rich.

14. In order to stimulate the economy and avoid deflation, some central banks have been implementing unconventional monetary policies, a combination of quantitative easing and negative policy rates. Which of the following best describes the outcome of such policy-mix?

- **A)** Commercial banks have switched to larger currency reserves.
- **B)** Yields on some sovereign bonds have turned negative.
- **C)** Overnight rates have remained relatively unchanged.
- **D)** Some banks have started charging interest on their corporate clients' deposits.
- **E)** Both B) and D).

Use this space for rough work.

PART II (40 marks)

Instructions: Answer the following four questions in the space provided. You may continue your answer on page 10 if additional space is required (***but clearly indicate that your answer continues on page 10***). Each question is worth 10 marks.

1. **Based on the case study discussed in class, critically evaluate the following statement:** *"As a result of strong macroeconomic-policy coordination, all developed and most emerging market countries achieved single-digit inflation and low interest rates during the first half of the 2000s."*

(Continue on page 10 if necessary)

2. **Critically evaluate the following statement:** *"If, due to greater uncertainty in the world economy, foreign investors choose to invest more in a safe country such as Canada, then Canada's output will rise, its rate of interest will increase, the balance in its capital account will improve, and the balance in its current account will deteriorate."* **(Show your answer with the help of a diagram and explain the economics. Consider the model of an open economy with a fixed-price level, flexible exchange rates, and imperfect capital mobility.)**

(Continue on page 10 if necessary)

3. **Based on the case study discussed in class, critically evaluate the following statement:** *"Before rewriting rulebooks and cranking up government spending, Canadians need to recall that central banks are far and away our best hope to cushion the downturn and hasten the recovery."* (William Robson, *The Globe and Mail*, 25/09/2008)

(Continue on page 10 if necessary)

4. **Comment on the following statement:** *"A sale of gold by the commercial banks to the Bank of Canada, a transfer of the Government of Canada's deposits from the Bank of Canada to the commercial banks, a sale of bonds by the general public to the commercial banks, and a decrease in the Bank Rate will all result in a decrease in the money supply."* **In your analysis, assume a fixed currency-deposit ratio of the public and a fixed desired cash-reserve ratio of the commercial banks.**

(Continue on page 10 if necessary)

(Continue on this page if necessary)