UNIVERSITY OF TORONTO
Faculty of Arts and Science

August Examination 2013

ECO 209Y

Duration: 2 hours

Examination Aids allowed: Non-programmable calculators only

LAST NAME ___________________________________

FIRST NAME __________________________________

STUDENT NUMBER _____________________________

DO NOT WRITE IN THIS SPACE

Part I		__________/40	3.	__________/12
Part II	1.	__________/12	4.	__________/12
	2.	__________/12	5.	__________/12
			TOTAL	__________/100

PART I (40 marks)

Instructions: Enter your answer to each question in the table below. Only the answers recorded in the table will be marked. Table cells left blank will receive a zero mark for that question. Each question is worth 2 marks. No deductions will be made for incorrect answers.

1	2	3	4	5	6	7	8	9	10
11	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**

1. In June 2011, a Canadian firm imports 50,000 electronic calculators from China at $5.00 each. By the end of the year, the firm sells 30,000 of these calculators to Canadian consumers at $15.00 each, exports 10,000 of them to the U.S. at $7.50 each, and keeps the remaining 10,000 calculators in inventory at cost price. The firm then sells these 10,000 calculators to Canadian consumers in February 2012 at $12 each. The impact of these transactions on Canadian GDP was
   a) an increase of $425,000 in 2011 and an increase $120,000 in 2012.
   b) a decrease of $200,000 in 2011 and a decrease of $50,000 in 2012.
   c) an increase of $325,000 in 2011 but no change in 2012.
   d) an increase of $325,000 in 2011 and an increase of $70,000 in 2012.
   e) There is no effect on Canadian GDP since the calculators were produced outside Canada.

Use this space for rough work.

2. In a flexible-price model of a closed economy, what will be the most likely short-run impact of expansionary monetary policy?
   a) Income and the price level will fall while the rate of interest will remain unchanged.
   b) Income, the price level, and the rate of interest will all fall.
   c) Income and the price level will rise while the rate of interest will fall.
   d) The rate of interest and the price level will rise while income will remain unchanged.
   e) None of the above.

3. If the Consumer Price Index had values of 150 in 2011 and 156 in 2012 and if the nominal rate of interest on one-year Government of Canada bonds was 4% in 2011. These figures imply that someone who invested in one-year Government bonds in 2011 would have realized a real rate of interest of approximately
   a) 0%.
   b) 1%.
   c) 2%.
   d) 3%.
   e) 4%.

4. Assume the objective of Bank of Canada policy is to keep the value of the Canadian dollar approximately fixed in terms of the US dollar. This will
   a) increase fluctuations in domestic monetary growth.
   b) increase the rate of interest in Canada.
   c) decrease the rate of interest in Canada.
   d) reduce the effectiveness of monetary policy.
   e) cause none of above.

Use this space for rough work.

5. Which of the following will cause the money supply to increase?
    a) An increase in government expenditures financed fully by new bond sales to the general public.
    b) An increase in government expenditures financed fully by new bond sales to the commercial banks.
    c) An increase in government expenditures financed fully by new bond sales to the Bank of Canada.
    d) An increase in government expenditures financed fully by new taxes.
    e) None of above.

6. If Canada is on a system of fully flexible exchange rates and the U.S. central bank increases the money supply, then
    a) the Canadian current account will improve.
    b) the Bank of Canada will have to raise the rate of interest.
    c) the Bank of Canada will have to sell US dollars.
    d) the Canadian dollar will increase in value.
    e) there will be no effect on the Canadian economy whatsoever.

7. 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 public to finance a new expenditure, the demand deposits of the public will
    a) remain unchanged.
    b) increase by $240.
    c) decrease by $240.
    d) increase by $80.
    e) decrease by $80.

Use this space for rough work.

8. Consider an economy with flexible prices, full employment, and fixed nominal money supply. If individuals decide to supply less labour at any real wage rate, which one of the following statements is correct?
    a) Both the real wage and the price level decrease.
    b) Both the real wage and the price level increase.
    c) The real wage increases and the price level decreases.
    d) The real wage decreases and the price level increases.
    e) The real wage increases while the price level stays constant.

9. In a closed economy, an increase in government expenditure will have the largest short-run impact on the level of output when it is financed by
    a) raising taxes to the rich.
    b) raising taxes to the middle class.
    c) borrowing from the public.
    d) borrowing from the central bank.
    e) cutting other expenditure programs.

10. The more flexible wages are,
    a) the flatter the AS curve will be.
    b) the steeper the LM curve will be.
    c) the steeper the IS curve will be.
    d) the steeper the Phillips curve will be.
    e) the flatter the AD curve will be.

11. All else equal, if people decide to hold more currency,
    a) the money multiplier will remain unchanged but money supply will fall.
    b) the monetary base and the money supply will both decrease.
    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 increase but the monetary base will not change.

Use this space for rough work.

12. Suppose a commercial bank has a target reserve ratio of 0.8 percent, but has an actual reserve ratio of 0.6 percent. This bank will likely
    a) contract its portfolio of loans.
    b) allow fewer cash withdrawals by the bank's customers.
    c) expand its portfolio of loans.
    d) maintain its new, lower reserve ratio because it is more profitable.
    e) buy government securities from the Bank of Canada.

13. Fiscal policy is much more effective in increasing national income if
    a) money demand is not very responsive to interest rate changes.
    b) the income tax rate is very high.
    c) investment is very responsive to interest rate changes.
    d) if the marginal propensity to save is high.
    e) investment is not very responsive to interest rate changes.

14. Looking at the macroeconomic statistics of a closed economy, you discover that at the beginning of the year the national money supply was equal to $400 million and by the end of the year it was equal to $412 million. You also found out that the inflation rate was 5%. In this case and assuming everything else equal, you would expect that
    a) both the equilibrium real rate of interest and the equilibrium level of income remained unchanged.
    b) the equilibrium real rate of interest fell and the equilibrium level of income increased.
    c) the equilibrium real rate of interest rose and the equilibrium level of income decreased.
    d) the equilibrium real rate of interest remained unchanged but the equilibrium level of income increased.
    e) both the equilibrium real rate of interest and the equilibrium level of income fell.

Use this space for rough work.

15. The marginal product of labour (measured in units of output) for New Age Nirvana is given by $MP_N = A(200 - N)$, where A measures productivity and N is the number of labour hours used in production. Assume that the price of output is \$5 per unit and that $A = 2.0$. What will be the quantity demanded of labour if the nominal wage is \$20?
    a) 185.
    b) 190.
    c) 195.
    d) 198.
    e) None of the above is correct.

16. Consider the flexible-price model of a closed economy. If an economy is presently producing at full employment, which one of the following statements best describes the long-run effects of expansionary monetary policy?
    a) Both the price level and output will remain unchanged.
    b) Output will decrease but the price level will increase.
    c) The price level will increase but output will remain unchanged.
    d) Output will increase but the price level will remain unchanged.
    e) Both the price level and output will increase.

17. Consider the fixed-price model of the economy. If the central bank wanted to maintain a constant interest rate after an increase in government spending, it would need to
    a) buy government bonds in open market operations.
    b) raise reserve requirements of commercial banks.
    c) increase the bank rate.
    d) increase the currency-deposit ratio of the public.
    e) do both c) and d).

Use this space for rough work.

18. Suppose that the Bank of Canada buys a painting for the new Governor's office. This will have a similar effect on the money supply as
    a) an increase in the cash reserve ratio of the commercial banks.
    b) an increase in the amount of currency the public wishes to hold.
    c) an open market purchase of government bonds.
    d) an intervention to prevent the Canadian dollar from depreciating.
    e) a rise in the bank rate.

19. Consider the following Classical model of the economy: 1) the economy's marginal product of labour is $MP_N = 200 - 0.5N$, where N is aggregate employment; and 2) the aggregate supply of labour is given by the expression $N = 300 + 8w$, where w is the real wage. What is the equilibrium quantity of employment in this economy?
    a) 12.
    b) 190.
    c) 380.
    d) 760.
    e) None of the above.

20. According to the fixed price model of the economy, an increase in government expenditure has a larger effect on income when
    a) the interest sensitivity of investment is relatively large.
    b) the marginal propensity to save is relatively large.
    c) the income sensitivity of money demand is relatively small.
    d) the marginal propensity to import is relatively large.
    e) the tax rate is relatively large.

Use this space for rough work.

PART II (60 marks)

<u>Instructions</u>: Answer <u>all</u> five questions in the space provided. All questions are of equal weight.

1. Not adjusted for inflation, the international price of soybeans increased from about \$200/ton in September 2006 to about \$615/ton in September 2012. What might have been the likely (positive and negative) effects of this price increase on the economy of a small soybean-exporting country? Would these effects be different if this country had a fixed instead of a flexible exchange rate system? What could the government of this country have done to reduce some of the negative impacts?

2. Critically evaluate the following statement: *"In the absence of active government policy, the long-run effect of a negative supply shock will be a higher price level, a lower output level, and a lower real wage rate."* (Show your answer with the help of a diagram and explain the economics. Consider the *AD-AS* model developed in class where the short-run aggregate supply (*SAS*) curve is given by the expression $P = P_{-1}\,[1 + \lambda(Y - Y^{*})]$ and assume that the economy was initially in long-run equilibrium.)

3. Critically evaluate the following statement: *“The undervaluation of the renminbi (the Chinese currency) is the underlying cause of the large deficit in the U.S. trade account.”*

4. Critically evaluate the following statement: *“Most economists believe that greater consumer and business confidence is needed to restore Canada’s economic activity to pre-recession levels. In this regard, Canada’s Finance Minister thinks that the biggest contribution his government can make to improve economic confidence is to reduce its own spending and debt.”*

5. Critically evaluate the following statement: *"A devaluation of the domestic currency will cause the level of income to increase, the rate of interest to rise, the balance in the current account to improve, and the balance in the capital account to deteriorate."* (Show your answer with the help of a diagram and explain the economics. Consider the fixed-price model of an open economy with imperfect capital mobility and assume that, initially, $BP = 0$.)

Use this space for rough work.