

UNIVERSITY OF TORONTO
Faculty of Arts and Science

August Examination 2017

ECO 209Y

Duration: 2 hours

Examination Aids allowed: A non-programmable calculator

LAST NAME _____

FIRST NAME _____

STUDENT NUMBER _____

DO NOT WRITE IN THIS SPACE

Part I _____/40

4. _____/10

Part II 1. _____/10

5. _____/10

2. _____/10

6. _____/10

3. _____/10

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 2.5 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

1. The Compagnie Naturelle sold 4,000 mounted butterflies in 2016 at \$14.75 each. To produce this quantity of mounted butterflies it bought \$20,000 in butterfly baits from another firm, paid its workers \$30,000, paid \$2,000 in indirect taxes, paid \$3,000 in interest to the bank, and had profits of \$4,000. What was its contribution to GDP in 2016?
A) \$3,000.
B) \$37,000.
C) \$39,000.
D) \$59,000.
E) None of the above is correct.
2. In 2016 private saving in the country of Latina was \$112 billion, consumption was \$350 billion, investment was \$114.5 billion, government expenditure on goods and services was \$124.5 billion, taxes were \$163.5 billion, and the surplus in the current account was \$26.5 billion. How much was the government budget surplus?
A) \$29 billion.
B) -\$29 billion.
C) \$39 billion.
D) -\$39 billion.
E) Not enough information to answer this question.
3. Which one of the following properly describes the impact of an increase in the marginal propensity to save?
A) The AE curve becomes steeper.
B) Equilibrium income decreases.
C) Planned investment increases.
D) The budget deficit decreases.
E) The rate of interest rises.

Use this space for rough work.

4. Consider an open economy with fixed price level, flexible exchange rates and imperfect capital mobility, where the positively-sloped BP curve is flatter than the LM curve. An increase in the level of government expenditure accompanied by an increase in the money supply that is chosen to keep the exchange rate unchanged will cause
- A) an increase in output but a decline in interest rates.
 - B) an increase in interest rates but a decline in output.
 - C) a decline in both interest rates and output.
 - D) an increase in both output and interest rates.
 - E) an increase in output but no change in interest rates.
5. Consider an open economy with fixed price level, flexible exchange rates and perfect capital mobility. A decrease in government expenditure will cause
- A) output, interest rates, and the exchange rate to increase.
 - B) output and interest rates to increase, but the exchange rate to fall.
 - C) the exchange rate and the level of output to rise, but the interest rate will remain unchanged.
 - D) output to rise and the exchange rate to fall while the interest rate will remain unchanged.
 - E) the exchange rate to rise, but the level of output and the interest rate will remain unchanged.
6. Consider an open economy with fixed price level, flexible exchange rates and imperfect capital mobility, where the positively-sloped BP curve is flatter than the LM curve. An increase in the money supply will cause
- A) output, the interest rate, and the exchange rate to increase.
 - B) output and the exchange rate to increase, while the interest rate will decrease.
 - C) output and the interest rate to increase, while the exchange rate will decrease.
 - D) output to decrease while the exchange rate and the interest rate will increase.
 - E) output to increase while the exchange rate and the interest rate will decrease.
7. 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 \$3 per unit and that $A = 2.0$. What will be 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.

8. If the money multiplier is 2 and the Bank of Canada buys \$1 million of bonds on the open market at the same time that it sells \$1.5 million of foreign exchange, then the money supply will
- A) increase by \$5 million.
 - B) increase by \$2 million.
 - C) increase by \$1 million.
 - D) fall by \$5 million.
 - E) fall by \$1 million.
9. 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.
10. Assume that the currency-deposit ratio is 0.2, the desired reserve-deposit ratio is 0.05, and total money supply is \$2,400 billion. What is the amount of high-powered money if there are no excess reserves in the banking system?
- A) \$750 billion.
 - B) \$700 billion.
 - C) \$650 billion.
 - D) \$500 billion.
 - E) None of the above is correct.
11. Consider an economy with a flexible price level, full employment, and fixed nominal money supply. If individuals decide to supply more labour at any real wage rate, which one of the following statements is correct?
- A) Both the real wage and the price level will decrease.
 - B) Both the real wage and the price level will increase.
 - C) The real wage will increase and the price level will decrease.
 - D) The real wage will decrease and the price level will increase.
 - E) The real wage will increase while the price level will remain constant.
12. China has been accused by Western countries of setting the value for its domestic currency too low in the past. 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 increase.
 - D) China will experience greater capital inflows.
 - E) None of the above is correct.

Use this space for rough work.

13. If the Bank of Canada responds to a negative supply shock by implementing expansionary monetary policy, then
- A) the inflation rate and the rate of unemployment will further increase.
 - B) firms will further increase their product prices and cut their production.
 - C) cost of production will be reduced and the AS curve will shift back to the right.
 - D) inflation will slowdown but unemployment will increase even more.
 - E) inflation will accelerate even more.
14. If nominal wages are constant while the price level is flexible, then the slope of the aggregate supply curve will be
- A) the same as when both nominal wages and the price level are fully flexible.
 - B) flatter than when both nominal wages and the price level are fully flexible.
 - C) steeper than when both nominal wages and the price level are fully flexible.
 - D) horizontal as in the Keynesian case.
 - E) vertical as in the Classical case.
15. Consider the flexible price model of a closed economy. If the government raises the HST (i.e., an indirect tax) and the Bank of Canada chooses a policy designed to prevent the price level from increasing, then
- A) output will decline and interest rates will rise.
 - B) output and interest rates will both rise.
 - C) output will rise and interest rates will fall.
 - D) output and interest rates will both decline.
 - E) output will remain unchanged and interest rates will rise.
16. 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 is correct.

Use this space for rough work.

PART II (60 marks)

Instructions: Answer all six questions in the space provided. If additional space is needed, you may continue any of your answers on page 12 (but clearly indicate that you are doing so). Each question is worth 10 marks.

1. **Critically evaluate the following statement:** *“Strong macroeconomic policy-coordination explains the single-digit inflation experienced by all developed countries and most major emerging markets since the turn of the millennium.”*

- 2. Critically evaluate the following statement:** *“Minimum wages are a good example of self-defeating interventionism since the well-meaning attempt to dictate higher wages ends up reducing employment and ultimately hurting the very workers they were supposed to help.”*

3. **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)

4. **Critically evaluate the following statement:** *“In the absence of an active government policy, the long-run effect of a negative supply shock will be a higher price level, a lower output level, and a higher real wage rate.”* **(Show your answer with the help of a diagram and explain the economics. Consider the short-run aggregate supply to be $P = P-1 [1 + \lambda(Y - Y^*)]$ and assume that the economy was in long-run equilibrium prior to the supply shock.)**

- 5. Critically evaluate 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 an increase in the target for the overnight 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.)**

6. **Critically evaluate the following statement:** *“An increase in consumers’ preference for vacationing abroad will lead to a decrease in domestic income, an increase in the domestic interest rate, an improvement in the capital account, and a deterioration in the current account.”* **(Show your answer with the help of a diagram and explain the economics. Consider the fixed-price model of an open economy with fixed exchange rates and imperfect capital mobility. Assume a deflationary gap at the initial equilibrium.)**

(Continue any of your answers on this page if additional space is needed)