ECO365, LEC5101

2021-10-29

TOTAL 90 MARKS. Answer all questions.

PART 1 . MULTIPLE CHOICE.   Total 60 marks (2 marks each) .Choose the best answer.

1) The sale of   1 _____
   A) the GNP does not include sale of used items priced below $1000.
   B) both a used textbook and a used house do not enter GNP.
   C) a used house does not enter GNP, but the sale of a used book does.
   D) a used textbook does enter GNP.
   E) a used textbook does not enter GNP, but the sale of a used house does.

2) An example of how GNP accounts for services provided by foreign-owned capital (and GDP   2) _____
   does not) is
   A) earnings of a Spanish factory with British owners counts only in Spain's GDP.
   B) earnings of a Spanish factory counts in Spain's GNP but not in Britain's GDP or GNP.
   C) earnings of a Spanish factory counts in Spain's GNP but are part of Britain's GDP.
   D) earnings of a Spanish factory counts in Spain's GDP but are part of Britain's GNP.
   E) earnings of a Spanish factory with British owners counts only in Britain's GNP.

3) A country's current account   3) _____
   A) balance equals the change in its net foreign wealth.
   B) balance equals its GNP.
   C) deficit equals the change in its foreign wealth.
   D) balance equals the change in its foreign wealth.
   E) surplus equals the change in its foreign wealth.

4) Which of the following is FALSE about private savings and government savings?   4) _____
   A)
      Total savings (S) = S^P + S^g.
   B) Unlike private saving decisions, government saving decisions are often made with an eye
      toward their effect on output and employment.
   C) The national income identity can help us to analyze the channels through which
      government saving decisions influence macroeconomic conditions.
   D) $S^P = Y - T - C$
   E) None of the above; all statements are true.

5) An American buys a Japanese car, paying by writing a check on an account with a bank in New   5) _____
   York. How would this be accounted for in the balance of payments?
   A) financial account, a U.S. asset export
   B) current account, a Japanese good import
   C) current account, a U.S. good import
   D) financial account, a U.S. asset import
   E) a current account as a U.S. good import and a financial account, a U.S. asset export

6) How many dollars would it cost to buy an Edinburgh Woolen Mill sweater costing 50 British pounds if the exchange rate is 1.80 dollars per one British pound? 6) _____
   A) 50 dollars
   B) 90 dollars
   C) 100 dollars
   D) 40 dollars
   E) 95 dollars

7) If the dollar interest rate is 10 percent, the euro interest rate is 12 percent, then 7) _____
   A) an investor should be indifferent between dollars and euros an investor should invest only in dollars if the expected dollar appreciation against the euro is 4 percent.
   B) an investor should invest only in dollars.
   C) an investor should invest only in dollars if the expected dollar appreciation against the euro is 4 percent.
   D) an investor should invest only in euros.
   E) an investor should invest only in euros an investor should invest only in dollars if the expected dollar appreciation against the euro is 4 percent.

8) Which one of the following statements is the MOST accurate? 8) _____
   A) For a given dollar interest rate and a constant expected exchange rate, a rise in the interest rate of the euro causes the dollar to depreciate.
   B) For a fixed interest rate, a rise in the expected future exchange rate does not cause a change in the current exchange rate.
   C) For a fixed interest rate, a rise in the expected future exchange rate causes a rise in the current exchange rate.
   D) For a fixed interest rate, a rise in the expected future exchange rate causes a fall in the current exchange rate.
   E) For a fixed interest rate, a fall in the expected future exchange rate causes a rise in the current exchange rate.

9) What is the expected dollar rate of return on dollar deposits if today's exchange rate is $1.10 per euro, next year's expected exchange rate is $1.165 per euro, the dollar interest rate is 10%, and the euro interest rate is 5%? 9) _____
   A) -1%   B) 11%   C) 15%   D) 10%   E) 0%

10) If the dollar interest rate is 10 percent and the euro interest rate is 6 percent, then an investor should

10) _____

    A) be indifferent between dollars and euros.
    B) invest only in euros.
    C) invest only in euros if the exchange rate is expected to remain constant.
    D) invest only in dollars if the exchange rate is expected to remain constant.
    E) invest only in dollars.

11) If there is initially an

11) _____

    A) excess supply of money, the interest rate will rise, and if there is also an excess demand, it will rise rapidly.
    B) excess supply of money, the interest rate will fall, and if there is initially an excess demand, it will rise.
    C) excess supply of money, the interest rate will rise, and if there is initially an excess demand, it will fall.
    D) excess demand for money, the interest rate will fall, and the supply of money it will rise.
    E) excess supply of money, the interest rate will fall, and if there is also an excess demand, it will fall rapidly.

12) An increase in

12) _____

    A) nominal output raises the interest rate while a fall in real output lowers the interest rate, given the price level and the money supply.
    B) real output raises the interest rate while a fall in real output lowers the interest rate, given the price level and the money supply.
    C) real output raises the interest rate while a fall in real output lowers the interest rate, given the money supply.
    D) nominal output raises the interest rate while a fall in real output lowers the interest rate, given the price level.
    E) real output decreases the interest rate while a fall in real output increases the interest rate, given the price level.

13) For a given level of   13) _____

    A) real GNP, changes in interest rates cause movements along the L(R,Y) schedule.

    B) real GNP, changes in interest rates cause an increase of the L(R,Y) schedule.

    C) nominal GNP, changes in interest rates cause an increase in the L(R,Y) schedule.

    D) nominal GNP, changes in interest rates cause movements along the L(R,Y) schedule.

    E) real GNP, changes in interest rates cause a decrease of the L(R,Y) schedule.

14) If there is an excess supply of money   14) _____

    A) the interest rate falls.

    B) the real money supply shifts right to make an equilibrium.

    C) the interest rate rises.

    D) the interest rate stays constant, but consumer confidence falters.

    E) the real money supply shifts left to make an equilibrium.

15) Given P_{US} and Y_{US} 15) _____

    A) An increase in the European money supply causes the euro to depreciate against the dollar, but it does not disturb the U.S. money market equilibrium.

    B) An increase in the European money supply causes the euro to appreciate against the dollar, and it creates excess demand for dollars in the U.S. money market.

    C) An increase in the European money supply causes the euro to depreciate against the dollar, and it creates excess demand for dollars in the U.S. money market.

    D) An increase in the European money supply causes the euro to appreciate against the dollar, but it does not disturb the U.S. money market equilibrium.

    E) An increase in the European money supply causes the euro to depreciate against the dollar, and disturbing the U.S. money market equilibrium.

16) A change in the level of the supply of money   16) _____

    A) decreases the long-run values of the interest rate and real output.

    B) has no effect on the long-run values of the interest rate and real output.

    C) has no effect on the long-run values of real output, but may affect the interest rate.

    D) increases the long-run values of the interest rate and real output.

    E) has no effect on the long-run values of the interest rate, but may affect real output.

17) The long run effects of money supply change   17) _____

    A) ambiguous effect on the long-run values of the interest rate or real output, a proportional change in the price level's long-run value in the opposite direction.

    B) ambiguous effect on the long-run values of the interest rate or real output, A disproportional change in the price level's long-run value in the same direction.

    C) proportional effect on the long-run values of the interest rate or real output, a proportional change in the price level's long-run value in the same direction.

    D) no effect on the long-run values of the interest rate or real output, no change in the price level's long-run value.

    E) no effect on the long-run values of the interest rate or real output, a proportional change in the price level's long-run value in the same direction.

18) An increase in the world relative demand for U.S. output causes   18) _____
    A) a long-run real appreciation of the dollar against the euro.
    B) a short-run real depreciation of the dollar against the euro.
    C) a short-run real appreciation of the euro against the dollar.
    D) a long-run real appreciation of the euro against the dollar.
    E) a long-run real depreciation of the dollar against the euro.

19) Which of the following statements is MOST accurate?   19) _____
    A) In the output market, a decrease in demand for U.S. output leads to a decrease in the
       long-run nominal dollar/euro exchange rate.
    B) In the output market, an increase in demand for U.S. output leads to an increase in the
       long-run nominal dollar/euro exchange rate.
    C) In the output market, an increase in the demand for European output leads to an increase in
       the long-run nominal euro/dollar exchange rate.
    D) In the output market, an increase in the demand for European output leads to an increase in
       the long-run nominal dollar/euro exchange rate.
    E) In the output market, an increase in the demand for European output leads to a decrease in
       the long-run nominal dollar/euro exchange rate.

20) The expected rate of change in the nominal dollar/euro exchange rate is best described as   20) _____
    A) the expected rate of change in the real dollar/euro exchange rate *plus* the U.S.-Europe
       expected inflation difference.
    B) the expected rate of change in the real dollar/euro exchange rate *minus* the U.S.-Europe
       expected inflation difference.
    C) the expected rate of change in the real dollar/euro exchange rate *minus* the U.S.-Europe real
       interest rate difference.
    D) the expected rate of change in the real dollar/euro exchange rate *plus* the European expected
       inflation.
    E) the expected rate of change in the real dollar/euro exchange rate *plus* the U.S.-Europe real
       interest rate difference.
  Which of the following statements is the MOST accurate?

21)   21)_
             ___
    A) In the long run, national price levels play a key role only in determining the relative prices at
       which countries' products are traded.
    B) In the long run, national price levels play a key role only in determining interest rates.
    C) In the long run, national price levels play a key role in determining both interest rates and
       the relative prices at which countries' products are traded.
    D) In the long run, national price levels play a minor role in determining both interest rates and
       the relative prices at which countries' products are traded.
    E) In the long run, national price levels play no role in determining interest rates and the
       relative prices at which countries' products are traded.

22) If people expect relative PPP to hold

    A) the difference between the interest rates offered by dollar and euro deposits will be below the difference between the inflation rates expected, over the relevant horizon, in the United States and Europe, respectively.

    B) the difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected, over the relevant horizon, in the United States and Europe, respectively, in the short run.

    C) the difference between the interest rates offered by dollar and euro deposits will be above the difference between the inflation rates expected, over the relevant horizon, in the United States and Europe, respectively.

    D) the difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected, in the United States and Europe, respectively, over the relevant horizon.

    E) the difference between the interest rates offered by dollar and euro deposits will equal the difference between the inflation rates expected in Europe and the United States, respectively.

22) _____

23) Under the monetary approach to the exchange rate

    A) a reduction in the money supply will cause immediate currency depreciation.

    B) a rise in the money supply will cause depreciation.

    C) a rise in the money supply will cause immediate currency depreciation.

    D) a rise in the money supply will cause currency depreciation.

    E) a rise in the money supply will cause immediate currency appreciation.

23) _____

24) Interest rate differences between countries depend on

    A) neither differences in expected inflation, nor on expected changes in the real exchange rate.

    B) differences in expected inflation, and on expected changes in the real exchange rate.

    C) differences in expected changes in the real exchange rate, but not on expected inflation.

    D) differences in expected inflation, but not on expected changes in the real exchange rate.

    E) differences in expected inflation and nothing else.

29) _____

25) The expected real interest rate (r^e) in terms of the nominal interest rate (R) and the expected inflation rate (π^e) is given by

    A) $r^e = R - \pi^e$.

    B) $r^e = 2\pi^e + R^2$.

    C) $r^e = R^2 - \pi^e$.

    D) $r^e = \pi^e + R^2$.

30) _____

E) $r^e = \pi^e + R$.

PART 2 . Total 40 marks. Answer all questions.

1. Show the full effects on the exchange rate of a permanent increase in the supply of money in Canada, where the exchange rate is defined as Canadian dollars per Euro. In your analysis incorporate the Interest Rate Parity Condition and the money market in Canada. Be certain to label all your diagrams correctly. Show the short run and long run effects. **(10 marks)**

2. "At time t_0 the Bank of Canada unexpectedly raises the growth rate of the Canadian money supply from 0% to 3%." Assume prices are flexible. With a written and graphical explanation, determine the effects over time on the level of the money supply, the nominal interest rate, the price level and the exchange rate. **(10 marks).**

3. Show the complete long run determinants of the nominal exchange rate, where it takes into account both the real and monetary factors. Also explain the real and monetary factors.

Which of these factors is the most important for affecting the value of the Canadian dollar?

4. "A change in the nominal interest rate will lead to a change in real interest rate differentials between countries" . With an explanation, determine whether this statement is true, false, or uncertain.   **(10 marks)**

(room for answers)