NAME: SURNAME(S):

Ljubljana Summer School - July 2012

Macroeconomics 1, Professor: Lorenzo Burlon

EXAM (VERSION A)- 27/07/2012

Instructions.

- Do not turn this page before the signal of the professor.
- The exam consists of 100 points distributed between two parts. The first part (multiple choice questions) accounts for 60% of the grade (60 points). The second part (open questions with graphs) accounts for 40% of the grade (40 points).
- The duration of the exam is 90 minutes (1h 30min).
- In the first part (multiple choice questions), each correct answer counts for 4 points and each incorrect answer counts for -1 point. A blank answer counts 0 points.
- The grades will be distributed on Friday, July 27 before 16:00, both online and in classroom P-127.

PART 1 - MULTIPLE CHOICE QUESTIONS

Report the answers to the first part (multiple choice questions) in the table here below.

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

1. Consider the quantity theory of money. Suppose that the velocity of money is constant. If real GDP grows by 3% per year, the money stock grows by 12% per year, and the nominal interest rate is 10%. What is the real interest rate?

   (a) 9%

   (b) 10%

   (c) 1%

   (d) 5%

2. Consider a closed economy in the short run. What is the condition that describes the equilibrium of the market for goods and services?

   (a) $Y = \bar{Y}$.

   (b) $Y = C(Y - \bar{T}) + I(r) + \bar{G}$.

   (c) $MV = PY$.

   (d) $Y = C(Y - \bar{T}) + I(r^*) + \bar{G} + NX(\epsilon)$.

3. Consider an open economy. Which of the following is true regarding the relation between public savings, private savings, and trade balance?

   (a) $(Y - T - C) - (T - G) = (EX - IM)$.

(b) $(Y - T - C) + (T - G) - I = (EX - IM)$.

(c) $(Y - T - C) - (T - G) + I = (EX - IM)$.

(d) $(Y - T - C) + (T - G) + I = (EX - IM)$.

4. According to the Keynesian cross model, the multiplier of government purchases depends positively on

   (a) the income.

   (b) the taxes.

   (c) the marginal productivity of labor.

   (d) the marginal propensity to consume.

5. According to the Keynesian cross model, the effect of an increase in government purchases is

   (a) a smaller increase of income than the one that is caused by a decrease in taxes of the same amount.

   (b) a bigger increase of income than the one that is caused by a decrease in taxes of the same amount.

   (c) an increase of income equal to the one that is caused by a decrease in taxes of the same amount.

   (d) no increase of income.

6. We derive the IS curve by assuming that the investment depends

   (a) negatively on the income.

   (b) positively on the income.

   (c) negatively on the interest rate.

   (d) positively on the interest rate.

7. A fiscal policy based on an increase in taxes can be represented in the IS-LM graph as

(a) a shift of the LM curve to the right (downwards).
(b) a shift of the IS curve to the right (upwards).
(c) a shift of the IS curve to the left (downwards).
(d) a shift of the LM curve to the left (downwards).

8. The crowding-out effect refers to the fact that

   (a) an expansionary fiscal policy decreases the interest rate and therefore increases private investment.
   (b) an expansionary monetary policy decreases the interest rate and therefore increases private investment.
   (c) an expansionary fiscal policy increases the interest rate and therefore decreases private consumption.
   (d) an expansionary fiscal policy increases the interest rate and therefore decreases private investment.

9. The LM curve represents

   (a) combinations of money supply and equilibrium income in the market for real money balances.
   (b) combinations of money supply and equilibrium interest rate in the market for real money balances.
   (c) combinations of equilibrium income and equilibrium interest rate in the market for real money balances.
   (d) combinations of money demand and equilibrium interest rate in the market fot real money balances.

10. A reduction of the money supply causes

   (a) an increase of income in the short run and a decrease of prices in the long run.

(b) a decrease of income in the short run and a decrease of prices in the long run.

(c) an increase of income in the short run and an increase of prices in the long run.

(d) a decrease of income in the short run and an increase of prices in the long run.

11. Consider the IS-LM model. Suppose that the target of the government is to increase the income level while maintaining constant the interest rate. Which combination of policies is compatible to achieve such a target?

    (a) An injection of money and an increase in government spending.

    (b) A reduction of money supply and an increase in government spending.

    (c) An injection of money and an increase in the tax rate.

    (d) A reduction of money supply and an increase in transfers.

12. With a fixed exchange rate, if a country experiences severe and repeated negative net exports, then at some point it will have to

    (a) revalue upwards its currency.

    (b) do nothing because a country with a fixed exchange rate always enjoys equilibrium of the trade balance.

    (c) devalue its currency.

    (d) provide credit to the rest of the world.

13. With a floating exchange rate, if the net outflow of capital exceeds the net exports, then

    (a) the new equilibrium exchange rate will correspond to an appreciation of our currency.

(b) the new equilibrium exchange rate will correspond to a depreciation of our currency.
(c) the central bank will intervene by revaluing our currency upwards.
(d) the central bank will intervene by devaluing our currency.

14. Each point on the Aggregate Demand (AD) curve represents the equilibrium of

(a) the markets of the factors of production.
(b) the labor market and the market for real money balances.
(c) the market for goods and services and the market for real money balances.
(d) the market for good and services and the labor market.

15. In the AD-LRAS framework, an increase in government spending causes in the long run

(a) a shift of the LRAS curve to the right with a reduction in prices.
(b) a shift of the AD curve to the right with an increase in prices.
(c) a shift of the AD curve to the right with an increase in income.
(d) none of the above.

PART 2 - THEORETICAL QUESTIONS WITH GRAPHS

Question 1 (20 points). Consider the IS-LM model. Represent graphically and show the effect on the equilibrium levels of income and real interest rate of each of the following shocks. If you can, explain the mechanism behind each effect.

1. There is an election and the new government declares that there are not enough public resources to guarantee the deposits from widespread bank failures.

2. On September 12, 2012 the German Federal Constitutional Court decides that the commitments of the European Stability Mechanism (ESM, a tool to provide fiscal stimulus to troubled economies) are constitutional. What happens to peripheral European economies?

Question 2 (20 points). Use the Mundell-Fleming model to answer the following question about Hungary, that is, a small open economy. Condition your answer on the type of exchange rate regime (floating vs fixed) you think Hungary is in. If Hungary falls into a recession, should the Hungarian government prefer the use of the monetary policy over the fiscal policy in order to restore the previous level of income? Justify your answer graphically.