

Name: _____

Midterm Exam #2 Econ 219 Fall 2005

This is a closed book exam. You are required to abide all the rules of the Student Conduct Code of the University of Connecticut.

Each multiple choice question is worth 2 points each. The last 5 problems are worth 4 points each.

1. If the currency-deposit ratio equals 0.5 and the reserve-deposit ratio equals 0.1, then the money multiplier equals:
 - A) 0.6.
 - B) 1.67.
 - C) 2.0.
 - D) 2.5.

2. If you spend \$3,000 per year in cash, each trip to the bank costs you \$5 in lost time, and the yearly interest rate on your bank account, expressed as a fraction, is 0.03, how many times a year does the Baumol-Tobin model suggest you should go to the bank?
 - A) one
 - B) two
 - C) three
 - D) four

3. In a small open economy, if exports equal \$5 billion and imports equal \$7 billion, then there is a trade _____ and _____ net capital outflow.
 - A) deficit; negative
 - B) surplus; negative
 - C) deficit; positive
 - D) surplus; positive

4. In a small open economy, if consumer confidence falls and consumers decide to save more, then the real exchange rate:
 - A) rises and net exports fall.
 - B) and net exports both rise.
 - C) falls and net exports rise.
 - D) and net exports both fall.

5. If the steady-state rate of unemployment equals 0.125 and the fraction of unemployed workers who find jobs each month (the rate of job findings) is 0.56, then the fraction of employed workers who lose their jobs each month (the rate of job separations) must be:
- A) 0.08.
 - B) 0.125.
 - C) 0.22.
 - D) 0.435.
6. If the short-run aggregate supply curve is horizontal, an increase in union aggressiveness that pushes wages and prices up will result in _____ prices and _____ output in the short run.
- A) higher; lower
 - B) lower; higher
 - C) higher; higher
 - D) lower; lower
7. Which of the following is an example of frictional unemployment?
- A) Dave searches for a new job after voluntarily moving to San Diego.
 - B) Elaine is willing to work for less than the minimum wage, but employers cannot hire her.
 - C) Bill is qualified and would like to be an airline pilot, but airlines do not find it profitable to hire him at the wage established by the airline pilot's union.
 - D) Joan is willing to work at the going wage, but there are no jobs available.
8. Assume that the money demand function is $(M/P)^d = 2,200 - 200r$, where r is the interest rate in percent. The money supply M is 2,000 and the price level P is 2. If the price level is fixed and the Fed wants to fix the interest rate at 7 percent, it should set the money supply at:
- A) 2,000.
 - B) 1,800.
 - C) 1,600.
 - D) 1,400.
9. In the Mundell-Fleming model with a floating exchange rate, a rise in the world interest rate will lead income:
- A) and net exports both to fall.
 - B) to rise and net exports to fall.
 - C) to fall and net exports to rise.
 - D) and net exports both to rise.

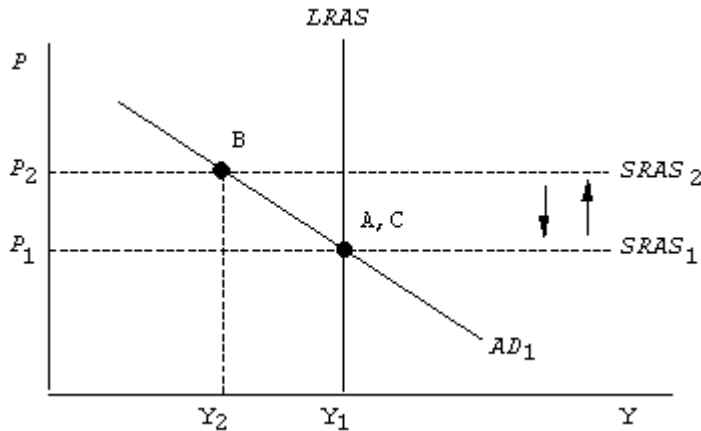
10. Those economists who believe that fiscal policy is more potent than monetary policy argue that the:
- A) responsiveness of investment to the interest rate is small.
 - B) responsiveness of investment to the interest rate is large.
 - C) *IS* curve is nearly horizontal.
 - D) *LM* curve is nearly vertical.

Use paper provided to answer the following questions. Keep your answers short and precise. Do not answer what you have not been asked.

11. Suppose that droughts in the Southeast and floods in the Midwest substantially reduce food production in the United States. Use the aggregate demand-aggregate supply model to illustrate graphically the impact in the short run and the long run of this adverse supply shock. Be sure to label: i. the axes; ii. the curves; iii. the initial equilibrium values; iv. the direction the curves shift; v. the short-run equilibrium values; and vi. the long-run equilibrium values. State in words what happens to prices and output in the short run and the long run.
12. Derive IS-LM model for the closed economy. Be sure to make your assumptions explicit. Provide an example of fiscal or monetary policy impact in the short run. Make sure you label your graphs.
13. What are the stylized facts of US business cycle?
14. Show the relationship between Mundel - Fleming model with flexible prices and aggregate demand relationship (AD).
15. Economic expansion throughout the rest of the world raises the world interest rate. Use the Mundell-Fleming model to illustrate graphically the impact of an increase in the world interest rate on the exchange rate and level of output in a small open economy with a floating-exchange-rate system. Be sure to label: i. the axes; ii. the curves; iii. the initial equilibrium levels; iv. the direction the curves shift; and v. the new short-run equilibrium.

Answer Key

1. D
2. C
3. A
4. C
5. A
6. A
7. A
8. C
9. D
10. A
11. In the short run output decreases, while the price level increases. In the long run, prices decrease and output returns to the full-employment level.



12. Look at your notes, or the notes online on the IS-LM model. You should have provided:
 - a) Derivation of IS curve (goods market equilibrium)
 - b) Derivation of LM curve (money market equilibrium)
 - c) An example of fiscal (shift in IS) or monetary (shift in LM) policy
13. Look at the notes online on the business cycle. You should have provided at least *some facts* from the list in the notes.
14. Look at the notes on the derivation of AD using M-F model with flexible prices. You should have provided a graphical representation of Mundel-Fleming model (IS^*-LM^*), and show that a change in the price level shifts LM^* and leads to a change in Y . This shift can be presented in $P \times Y$ plane as AD relationship.

15.

