Exam practice problems

(1) When production costs rise

a. the short-run aggregate supply curve shifts to the right.

b. the short-run aggregate supply curve shifts to the left.

c. the aggregate demand curve shifts to the right.

d. the aggregate demand curve shifts to the left.

(2) Which of the following would make the price level decrease and real GDP increase?

a. Long-run aggregate supply shifts right.

b. Long-run aggregate supply shifts left.

c. Aggregate demand shifts right.

d. Aggregate demand shifts left.

(3) Which of the following could be a consequence of an appreciation of the U.S. real exchange rate?

a. John, a French citizen, decides that Iowa pork has become too expensive and cancels his order.
b. Nick, a U.S. citizen, decides that his trip to Nepal would be too costly and cancels his trip.
c. Roberta, a U.S. citizen, decides to import fewer windshield wipers for her auto parts company.
d. All of the above are correct.

After appreciation, import is more expensive for foreigners

(4) The law of one price states that

a. a good must sell at the price fixed by law.
b. a good must sell at the same price at all locations.
c. a good cannot sell for a price greater than the legal price ceiling.
d. domestic producers of a good are guaranteed a subsidy by law

(5) If there is a shortage of loanable funds,

a. the demand for loanable funds will shift right so the interest rate rises.
b. the supply of loanable funds will shift left so the interest rate falls.
c. there will be no shifts of the curves, but the interest rate rises.
d. there will be no shifts of the curves, but the interest rate falls

(6) Which of the following is included in the demand for dollars in the market for foreign-currency exchange in the open-market macroeconomic model?

a. A firm in Kenya wants to buy wheat from a U.S. firm.
b. A Japanese bank desires to purchase U.S. Treasury securities.
c. An U.S. citizen wants to buy a bond issued by a Mexican corporation.
d. All of the above are correct.

(7) If the government started with a budget deficit and moved to a surplus, domestic investment would

a. rise and the trade balance would move towards surplus.
b. rise and the trade balance would move towards deficit.
c. fall and the trade balance would move towards surplus.
d. fall and the trade balance would move towards deficit.

(8) Which of the following contains a list only of things that increase when the budget deficit of the U.S. increases?

a. U.S. supply of loanable funds, U.S. interest rates, U.S. domestic investment
b. U.S. imports, U.S. interest rates, the real exchange rate of the dollar
c. U.S. interest rates, the real exchange rate of the dollar, U.S. domestic investment
d. the real exchange rate of the dollar, U.S. net capital outflow, U.S. net exports

(9) The money supply in Freedonia is $200 billion. Nominal GDP is $800 billion and real GDP is $400 billion. Assuming that velocity is stable, if real GDP grows by 10 percent this year, and if the money supply does not change this year, then

a. the inflation rate will be zero.
b. nominal GDP will grow by 10 percent.
c. nominal GDP will stay the same.
d. none of the above are correct

(10) The Fisher effect says that

a. the nominal interest rate adjusts one for one with the inflation rate.
b. the growth rate of the money supply determines the inflation rate.
c. real variables are heavily influenced by the monetary system.
d. All of the above are correct.

True/False questions

1) In a closed economy, investment must be equal to private saving. (**F**)

2) Other things the same, an increase in the nominal exchange rate raises the real exchange rate. (**T**)

3) In an open economy, the demand for loanable funds comes from both domestic investment and net capital outflow. (**T**)

4) Like real GDP, investment fluctuates, but it fluctuates much less than real GDP. (**F**)

5) When a company from Germany builds an automobile factory in the United States, the German firm has engaged in foreign direct investment. (**T**)

Problems to solve

1) If a country makes political reforms so that people now believe this country's assets are less risky, what happens to its interest rate, its exchange rate, and its net exports? Explain your answer.

ANSWER: Something opposite of the capital flight happens. Its interest rate falls as risk declines; its exchange rate rises as more investments are incoming; and its net exports fall due to currency appreciation.

2) Suppose that people expect inflation to equal 3 percent, but in fact, prices rise by 5 percent. Describe how this unexpectedly high inflation rate would help or hurt the following:

a. the government

Unexpectedly high inflation helps the government by providing higher tax revenue and reducing the real value of outstanding government debt.

b. a homeowner with a fixed-rate mortgage

Unexpectedly high inflation helps a homeowner with a fixed-rate mortgage because he pays a fixed nominal interest rate that was based on expected inflation, and thus pays a lower real interest rate than was expected.

c. a union worker in the second year of a labor contract

Unexpectedly high inflation hurts a union worker in the second year of a labor contract because the contract probably based the worker's nominal wage on the expected inflation rate. As a result, the worker receives a lower-than-expected real wage.

3) Would each of the following groups be happy or unhappy if the U.S. dollar appreciated? Explain.

a. Dutch pension funds holding U.S. government bonds

Dutch pension funds holding U.S. government bonds would be happy if the U.S. dollar appreciated. They would then get more Dutch guilders for each dollar they earned on their U.S. investment. In general, if you have an investment in a foreign country, you are better off if that country's currency appreciates.

b. U.S. manufacturing industries

U.S. manufacturing industries would be unhappy if the U.S. dollar appreciated because their prices would be higher in terms of foreign currencies, which will reduce their sales.

b. Australian tourists planning a trip to the United States

Australian tourists planning a trip to the United States would be unhappy if the U.S. dollar appreciated because they would get fewer U.S. dollars for each Australian dollar, so their vacation will be more expensive.

d. An American firm trying to purchase property overseas

An American firm trying to purchase property overseas would be happy if the U.S. dollar appreciated because it would get more units of the foreign currency and could thus buy more property.