ECO 103, Winter 2015, Practice Final Exam

Name:

Instructions: Answer all parts of all questions. You have 80 minutes to complete the exam. This exam is open note. You are welcome to use any written materials that you might find helpful. Calculators, but no other electronic devices, are allowed. Here are some things to keep in mind.

i. Explain all of your answers. Unsupported answers will receive little or no credit.

ii. On true/false questions, I only care about the quality of your explanation. Simply writing “true” or “false” will yield no credit.

iii. Avoid extensive irrelevance, this will also cost you points. Your goal should be to provide clear and concise explanations.

iv. It is more important to demonstrate that you understand the correct method. Minor math errors will result in only minor deductions.

v. All parts of all questions are worth the same amount.

vi. Many questions ask you about a deviation from something that we did in class. If you simply copy down what we did in class, I will award no credit.

1. Comparative Questions.

a. The U-3 unemployment rate is currently 5.5%. Does this suggest that the labor market is almost fully recovered from the recent recession?

b. If households reduce their consumption rate in the Solow Model, output rises. Does this contradict the AS/AD model?

c. True or False? If the fiscal multiplier is zero, then additional government spending is surely bad policy.

2. Monetary Policy

For a and b assume that inflation is initially at its target and that the Central Bank wants to keep it there.

a. Suppose that the current, one year, interest rate is 5% and future interest rates are expected to always be 9%. What will the 2 year interest rate equal?

b. From, a, illustrate how forward guidance can be used to lower short and longer term interest rates/

c. True or False? By lowering the money supply, Central Banks also lower interest rates.

d. Suppose that taxes increase. What must a Central Bank to in order to keep output from falling?

3. The AS/AD Model

a. In the 1970's technological progress appears to have slowed. What would have been the effects on the output gap and inflation? [Assume inflation initially equaled its target and that output initially equaled its natural rate.]

b. From a, if fiscal policy makers wanted to prevent inflation from not equaling its target, what policies should they have pursued?

c. From a, if fiscal policy makers wanted to prevent output from not equaling its natural rate, what policies should they have pursued?

d. How would your answers to b and c have changed if the AS curve were vertical?

4. Fiscal Policy

a. Why do sovereign debt crises often cause recessions to get worse?

b. True or False? If a country runs a budget deficit, then its debt to GDP ratio must increase.

c. Do recessions, absent any policy changes, cause budget deficits to get larger or smaller?

d. Suppose that consumption, investments, imports, and exports are all constant. What is the government spending multiplier equal to?

5. The Great Recession

a. Why did mortgage defaults increase at about the same time housing prices started to fall?

b. True or False? All U.S. interest rates during the Great Recession were very close to zero (less than 1%).

c. Why did the Federal Reserve purchase over a trillion dollars of mortgage backed securities?

d. True or False. The private sector employment rate has shown no signs of recovery since the recession ended?