

ECO 103, Winter 2021, Exam #2

Name:

Instructions: Answer all parts of all questions. You have 90 minutes to complete the exam. This exam is open note, but not open book. You are welcome to use any written materials that you might find helpful excluding textbooks. 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.

Consider the following employment data for questions #1-2:

Table 1: Employment Data

	May 2021	June 2021
Population	200	200
Employed	170	165
Unemployed (ASW)	15	10
Underemployed	10	15
Discouraged Workers	5	10

1. Calculate the U-3 unemployment rate in both May and June.

2. Did the labor market improve or weaken between May and June? To receive full credit, use the data from the table to construct an appropriate measure of the health of the labor market.

3. Most structural unemployment is involuntary and is typically damaging to the households suffering from it. How do most economic policy makers try to cope with structural unemployment?

4. True or False? If wages are flexible, then changes to aggregate demand have very large effects on output.

For questions #5-7, suppose that lower productivity causes firms to demand less labor. For simplicity, assume that, prior to this event, the output gap is zero and that inflation is at target. Assume that wages are sticky in the short-run.

5. Using the AS/AD model (you very likely want a graph), show how output and inflation are affected in the short-run.

6. What will happen to unemployment in the short-run?

7. What will happen if the Central Bank responds to lower productivity by raising interest rates?

8. Why do governments often raise spending or cut taxes during recessions?

9. Why are more liquid assets more likely to be counted as money.

10. Briefly describe the trade-offs involved with switching from commodity backed money to fiat money.

11. For question #11, refer to the following table:

Table 2: Value of Assets in the Economy

Asset	Value
Electronic Reserves at the Central Bank	50
Real Estate	200
Corporate Bonds	100
Checkable Deposits	40
Currency	40

11. Calculate the monetary base and M1 money supply.

12. What social problem does having an independent Central Bank (as opposed to elected officials) conduct monetary policy potentially solve?

13. Suppose that May's inflation data comes in higher than expected. How might this impact the Federal Reserve's monetary policy?

14. Expansionary monetary policy often increases output and reduces unemployment. Given this, why don't Central Banks always engage in expansionary monetary policy?

15. True or False? When the Federal Reserve lowered interest rates during the covid-19 pandemic, it did so by conducting open market sales.

Bonus: How would your answers to #5-7 change if wages were fully flexible?