Econ 102
Practice Questions for Test II

Chapters 10-12

1. Explain how the size of the MPC affects the slope of the IS curve.
2. Explain how government expenditure and tax multipliers differ.
3. Explain how a shift in the IS curve would affect velocity.
4. How does a tightening of monetary policy affect the LM curve?
5. How would a shift to rapid expansion of the money supply affect nominal rates
    a. In the short run?
    b. In the long run?
6. How would a domestic boom affect the IS curve?
7. Through what mechanism do changes in monetary policy affect income in ISLM analysis?
8. Explain whether the ISLM model is a theory of aggregate demand (AD) or aggregate supply (AS)
9. Explain whether the Great Depression started with a shock to the IS or the LM curve
10. Explain how monetary policy contributed to the size of the depression.
11. Explain what happened to nominal and real interest rates during the depression.
12. According to the Pigou effect, how would falling prices affect AD?
13. What does the Fed normally do to expand the money supply?
14. Will this strategy work if the economy is in a liquidity trap?
15. In this case what would happen to the money multiplier?
16. In a liquidity trap, what could the Fed do to ease credit conditions?

Now back to a normal economy.

17. Explain how a shift form a constant money supply to a constant interest rate target for monetary policy would affect the government expenditure multiplier?

Now assume a Mundell-Fleming open economy model.

18. How does devaluation or depreciation shift the IS curve?
19. How does an increase in capital mobility affect the slope of the BP curve?
20. Under a fixed exchange rate, how would fiscal expansion affect
    a. The trade balance
    b. Capital flows
21. Under flexible rates with low capital mobility, how would a fiscal expansion affect the exchange rate?
22. How would the change in the exchange rate affect the strength of fiscal policy?

23 - 24. Now answer 21 and 22 for the case of high capital mobility?

25. Under fixed rates what does high capital mobility do to the effectiveness of monetary policy?
26. Under flexible rates, how will monetary tightness affect the exchange rate?
27. Will this effect be greater with high or low capital mobility?
28. In full equilibrium, how would a tariff affect the trade balance?
29. How could these effects differ under fixed exchange rates with sterilization?
30. Under the gold standard, explain whether countries were supposed to sterilize.
31. If a country's currency is expected to depreciate how will this affect a country's nominal interest rate?
32. How would increased risk of a financial crisis affect a country's interest rate?

33 – 34. What is a major cost of fixed exchange rates? Of flexible rates?

35. Do fixed rates make more sense for a large or a small country?

36 – 37. Does a currency board provide strong discipline over monetary policy? Over fiscal policy?

38. What has been China's solution to the impossible trinity?

39. If China is at full employment and revalued the RMB, how, if any, should it change fiscal policy?

40. Why has the adjustable peg exchange rate regime often generated currency crises?

41. What is the one way speculative option?

Chapter 13

1. Explain two reasons why the AS curve is neither perfect vertical or horizontal in the medium term.

2-5. How would the following developments shift the Phillips curve?

2. Actual inflation higher than was expected.

3. Unemployment above the natural rate.

4. A big increase in oil prices.

5. The appointment of a new Fed chairman who is expected to be tougher on inflation.

6. Explain the difference between demand-pull and cost-push inflation using a Phillips curve.

7. How does the credibility of a government's anti-inflation affect the economy's sacrifice ratio?

8. Why might the adoption of an anti-inflation policy not be credible?

9. How does the modern Phillips curve differ from the original formulation?

10. If a credible anti-inflation policy is adopted, explain the differences in how the Phillips curve would shift under adaptive and under rational expectations.

11. How does hysteresis affect the path of unemployment during a recession?

Chapter 14

1. Explain the Taylor Rule.
2. How did Fed policy contribute to the Great Inflation of the 1970s?
3. What are the differences in the mandates of the Fed and the ECB?
4. How would this affect their responses to a cost-push inflation?