

Assignment 8 (OPTIONAL)

Total Marks: 50

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question. Each question is worth 2 marks.

- 1) How does a rise in real income affect aggregate demand? 1) _____
- A) $Y \uparrow \rightarrow Y_d \uparrow \rightarrow Im \downarrow \rightarrow CA \downarrow \rightarrow AD \downarrow$, but $Y \uparrow \rightarrow Y_d \uparrow \rightarrow C \uparrow \rightarrow AD \uparrow$ by less
 - B) $Y \uparrow \rightarrow Y_d \uparrow \rightarrow Im \downarrow \rightarrow CA \downarrow \rightarrow AD \downarrow$, but $Y \uparrow \rightarrow Y_d \uparrow \rightarrow C \uparrow \rightarrow AD \uparrow$ by more
 - C) $Y \uparrow \rightarrow Y_d \uparrow \rightarrow Im \uparrow \rightarrow CA \downarrow \rightarrow AD \downarrow$, but $Y \uparrow \rightarrow Y_d \uparrow \rightarrow C \uparrow \rightarrow AD \uparrow$ by less
 - D) $Y \uparrow \rightarrow Y_d \uparrow \rightarrow Im \uparrow \rightarrow CA \uparrow \rightarrow AD \uparrow$, and $Y \uparrow \rightarrow Y_d \uparrow \rightarrow C \uparrow \rightarrow AD \uparrow$
 - E) $Y \uparrow \rightarrow Y_d \uparrow \rightarrow Im \uparrow \rightarrow CA \downarrow \rightarrow AD \downarrow$, but $Y \uparrow \rightarrow Y_d \uparrow \rightarrow C \uparrow \rightarrow AD \uparrow$ by more
- 2) If the representative basket of European goods and services costs 40 euros, the representative U.S. basket costs \$50, and the dollar/euro exchange rate is \$0.90 per euro, then the price of the European basket in terms of U.S. basket is 2) _____
- A) $[(0.9\$/\text{euro}) (50\$/\text{U.S. basket})]/[(40 \text{ euro per European basket})]$
 - B) $[(40 \text{ euro per European basket})]/[(50\$/\text{U.S. basket}) (0.9\$/\text{euro})]$
 - C) $[(0.9\$/\text{euro}) (40 \text{ euro per European basket})]/[(50\$/\text{U.S. basket})]$
 - D) $[(50\$/\text{U.S. basket})]$
 - E) $[(0.9\$/\text{euro}) (40 \text{ euro per European basket})]/[50\$]$
- 3) In the short-run, a temporary increase in government spending causes 3) _____
- A) A shift of the DD curve to the left, output decreases and the currency depreciates
 - B) A shift of the DD curve to the left, output increases and the currency appreciates
 - C) A shift of the DD curve to the right, output decreases and the currency appreciates
 - D) A shift of the DD curve to the right, output increases and the currency depreciates
 - E) A shift of the DD curve to the right, output increases and the currency appreciates
- 4) In the short run, a permanent increase in the domestic money supply causes 4) _____
- A) an upward shift in the AA curve which is greater than that caused by an equal but transitory increase
 - B) a downward shift in the AA curve which is greater than that caused by an equal but transitory increase
 - C) an upward shift in the AA curve which is smaller than that caused by an equal but transitory increase
 - D) a downward shift in the AA curve which is smaller than that caused by an equal but transitory increase
 - E) an upward shift in the DD curve which is greater than that caused by an equal but transitory increase

- 5) In the short-run, any rise in the real exchange rate, EP^*/P , will cause 5) _____
- A) A downward shift in the aggregate demand function and an expansion of output
 - B) An upward shift in the aggregate demand function and an expansion of output
 - C) An downward shift in the aggregate demand function and a reduction in output
 - D) An upward shift in the aggregate demand function and a reduction in output
 - E) An upward shift in the aggregate demand function but leaves output intact
- 6) Imperfect asset substitutability assumes: 6) _____
- A) The returns on foreign and domestic currency bonds are the same.
 - B) The returns on foreign and domestic currency are influenced by risk.
 - C) The returns on foreign and domestic currency are different.
 - D) Both B and C.
 - E) Sterilized intervention proves to be unproductive.
- 7) When a country's currency is devalued: 7) _____
- A) The money supply decreases.
 - B) Output increases.
 - C) Output decreases.
 - D) The money supply increases.
 - E) Both B and D.
- 8) Which one of the following statements is most true? 8) _____
- A) Any central bank purchase of assets results in an increase in the domestic money supply, while any central bank sale of assets causes the money supply to decline.
 - B) Any central bank purchase of assets *automatically* results in a decrease in the domestic money supply, while any central bank sale of assets *automatically* causes the money supply to increase.
 - C) Any central bank purchase of assets *automatically* results in a decrease in the domestic money supply, while any central bank sale of assets *automatically* causes the money supply to decline.
 - D) Any central bank purchase of assets *automatically* results in an increase in the domestic money supply, while any central bank sale of assets *automatically* causes the money supply to decline.
 - E) None of the above statement is true.

9) Which one of the following statements is the most true? 9) _____

A) If central banks are not sterilizing and the home country has a balance of payments surplus, any associated increase in the home central bank's foreign asset implies a decreased home money supply.

B) If central banks are not sterilizing and the home country has a balance of payments surplus, any associated decrease in the home central bank's foreign asset implies an increased home money supply.

C) If central banks are not sterilizing and the home country has a balance of payments surplus, any associated increase in the home central bank's foreign asset implies an increased home money demand.

D) If central banks are not sterilizing and the home country has a balance of payments surplus, any associated increase in the home central bank's foreign asset implies an increased home money supply.

E) None of the above statements is true.

10) Under fixed exchange rate, in general, 10) _____

A) The domestic and foreign interest rates are equal, $R = R^*$

B) $R = R^* + (E^e - E)/E$

C) None of the above

D) E is equal to one.

E) One of the above

11) Which one of the following statements is the most accurate in the short-run? 11) _____

A) Fiscal policy affects output more under fixed than under flexible exchange rate regimes.

B) Fiscal policy cannot affect output under fixed exchange rate but does affect output under flexible exchange rate regimes.

C) Fiscal policy has the same effect on output under fixed and flexible exchange rate regimes.

D) Fiscal policy affects output less under fixed than under flexible exchange rate regimes.

E) None of the above statements is true.

12) The expectation of future devaluation causes a balance of payments crisis marked by

12) _____

A) a sharp rise in reserves and a fall in the home interest rate below the world interest rate

B) a sharp fall in reserves and an even bigger fall in the home interest rate below the world interest rate

C) a sharp rise in reserves and an even greater rise in the home interest rate above the world interest rate

D) a sharp fall in reserves and a rise in the home interest rate above the world interest rate

E) None of the above.

13) When domestic and foreign currency bonds are imperfect substitutes, the domestic interest rate (R) can be written as 13) _____

- A) $R = R^* - (E^e + E)/E + \rho$
- B) $R = R^* - (E^e - E)/E$
- C) $R = R^* - (E^e - E)\rho$
- D) $R = R^* - (E^e - E)/E + \rho$
- E) $R = R^* + (E^e - E)/E + \rho$

14) A sudden increase in the U.S. price level 14) _____

- A) Makes those with dollar debts better off
- B) Do not affect those with dollar debts
- C) Makes those with DM debt better off
- D) Makes those with dollar debts worse off
- E) None of the above.

15) Which one of the following statements is true? 15) _____

- A) Countries with weak investment opportunities should invest little at home and channel their savings into more productive investment activity abroad.
- B) Countries with weak investment opportunities should invest more at home.
- C) Countries with strong investment opportunities should invest little at home and channel their savings into more productive investment activity abroad.
- D) Countries with weak investment opportunities should invest little abroad.
- E) None of the above statement is true.

16) Countries with 16) _____

- A) strong investment opportunities should invest more at home and less abroad.
- B) weak investment opportunities should invest more at home.
- C) strong investment opportunities should invest little at home and channel their savings into more productive investment activity abroad.
- D) weak investment opportunities should invest little abroad.
- E) None of the above statement is true.

17) Under fixed exchange rates, 17) _____

- A) Monetary policy is not an effective policy.
- B) Fiscal policy is not an effective policy.
- C) Both monetary and fiscal policies are effective.
- D) Monetary policy and fiscal policy are not effective.
- E) None of the above.

- 18) The XX schedule shows how much 18) _____
- A) fiscal expansion is needed to hold the current account surplus at X as the currency is evaluated by a given amount
 - B) fiscal and monetary expansions are needed to hold the current account surplus at X as the currency is devalued by a given amount
 - C) monetary expansion is needed to hold the current account surplus at X as the currency is devalued by a given amount
 - D) fiscal expansion is needed to hold the current account surplus at X as the currency is devalued by a given amount
 - E) None of the above statements is true.
- 19) By internal balance, most economists mean 19) _____
- A) Price stability
 - B) Full employment
 - C) Full employment and price stability
 - D) Full employment and moderate increase in prices
 - E) None of the above.
- 20) By external balance, most economists means, 20) _____
- A) Balance between exports and imports
 - B) Avoiding excessive imbalances in international payments
 - C) Balance between trade account and service account
 - D) Fixed exchange rate
 - E) None of the above.
- 21) Advocates of floating rate suggested it is favorable for economies for the following reasons EXCEPT 21) _____
- A) It helps stabilize the shock effect on unemployment in case of economic changes such as fall in export demand.
 - B) It discourages attack from foreign exchange speculators because of the fact that exchange rate adjustment is immediate.
 - C) It automatically matches the domestic inflation with ongoing foreign inflation.
 - D) It brings the LR exchange rate to the level predicted by PPP without government policy decisions.
 - E) It gives every country the opportunity to guide its own monetary conditions at home.
- 22) Which of the following is NOT a result of a *temporary* fall in foreign demand on one country's exports under *floating* exchange rate? 22) _____
- A) A fall in aggregate output.
 - B) The DD curve shifts to the left due to reduction of aggregate demand.
 - C) The AA curve shifts downwards due to reduction of money supply.
 - D) Depreciation in home country's currency.
 - E) None of the above.

- 23) Which one of the following statements is true? 23) _____
- A) By *revaluing* its currency, that is, by *increasing* the domestic currency price of foreign currency, a country can insulate itself completely from an inflationary increase in foreign prices.
 - B) By *revaluing* its currency, that is, by lowering the domestic currency price of foreign currency, a country *cannot* insulate itself completely from an inflationary increase in foreign prices.
 - C) By *devaluing* its currency, that is, by *lowering* the domestic currency price of foreign currency, a country *can* insulate itself completely from an inflationary increase in foreign prices.
 - D) By *revaluing* its currency, that is, by *lowering* the domestic currency price of foreign currency, a country *can* insulate itself completely from an inflationary increase in foreign prices.
 - E) None of the above.

- 24) The case against floating exchange rates is because of 24) _____
- A) Injury to international trade and investment
 - B) Uncoordinated economic policies
 - C) The illusion of greater autonomy
 - D) Discipline and destabilizing speculation and money market disturbances
 - E) All of the above.

- 25) If most of the shocks that buffet the economy come from the home money market then, 25) _____
- A) Fixed exchange rate is better than flexible exchange rates only in the short run.
 - B) Fixed exchange rate is better than flexible exchange rates.
 - C) Which system is chosen is not important.
 - D) Flexible exchange rate is better than fixed exchange rates.
 - E) Flexible exchange rate is better than fixed exchange rates only in the short-run.