Wilfrid W. Csaplar Jr., Ph.D. Economics 350 Exam #3 2006/11/08

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. The Excel file will be handed in via Moodle. Your name will only appear on a page of the file that has nothing else on it. Failure to follow these directions will cost you 1 point. The test has 100 points (to be scaled up to 170 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 10-point question should take 5 minutes. I cannot give extra time because of the class which follows yours.

1) (12 points) For EITHER *fully anticipated high inflation* OR *high unemployment*, explain TWO problems it causes.

2) (12 points) Answer EITHER Part A OR Part B.
A) Suppose a country has an over-valued exchange rate which is fixed. What will automatically happen to their money supply? Explain your logic.
B)Suppose that yesterday the exchange rate was £0.5/$ and today it is $1.9/£. Did the dollar appreciate or depreciate? Show your work. Who in the USA would like this and who would not? Briefly explain your logic.

3) (14 points) Answer EITHER Part A OR Part B.
A) Yesterday was election day. Incumbent politicians tend to dislike high unemployment more than high inflation. Can the incumbents reduce the unemployment rate and move along the Short-run Phillips Curve to a higher inflation rate? If yes, then explain how. If not, then explain why they cannot.
B) For either of the two explanations of the natural rate of unemployment, what could the government do to reduce it? Explain how that action would reduce the natural rate of unemployment.

4) (18 points) Illustrate EITHER the event in Part A OR the event in Part B on the supply and demand for US$ measured in terms of euro (€). Explain why the curve(s) moved. Which country's currency appreciated? How can you tell?
A) Interest rates in the USA increase.
B) The EU's GDP increases.

5) (20 points) Run the regression using the data on Page #5 on exam3.xls to predict quantity as a function of income and price. On the spreadsheet, calculate what you would expect the quantity sold to be if a person's income is $2000 and the price is $9/unit. Check for multi-collinearity. **If you find it**, rerun the regression after correcting for the problem. Explain what you did and why you did it. **If you do not find multi-collinearity**, tell me how good the regression is as a whole and tell me which variables are statistically significant.

6) (24 points) Use the data on Page #6 on exam3.xls to run a regression which would predict the *GDP* based upon *Government Spending*. Do the visual tests for BOTH heteroscedasticity and auto-correlation. **If there is heteroscedasticity**, do the formal test. If you did the test correctly, the cutoff point will be 2.27. **If there is auto-correlation**, then explain how you know there is a problem. What would you do to correct the problem? Explain what you would do without actually doing it. **If neither exist**, then calculate on the spreadsheet what you would expect GDP to be if the government spending is 500. Would you rely on this number? Explain your logic.