

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. You can have the full two hours.

1) (12 points) Answer EITHER Part A OR Part B.

A) Without drawing the diagrams, explain how an increase in the GDP in the USA could cause the GDPs of many other countries to increase.

B) Why would you expect *Absolute Purchasing Power Parity* (PPP) to hold? Why might it not hold?

2) (12 points) Answer EITHER Part A OR Part B.

A) How can *tax-based income policies* (TIP) help reduce inflation? Why might they make the problem worse?

B) What are wage and price controls? Why are they a bad method to fight inflation?

3) (16 points) Answer EITHER Part A OR Part B.

A) Draw the Short-run Phillips Curve/Long-run Phillips Curve diagram. Suppose the expected inflation rate used to be 5% but now people expect the money supply to grow 2%. Illustrate what would happen on those curves if the actual money supply growth was 4%. Assume we started at full employment. Explain why the curve(s) moved as drawn and how you found where the economy ended.

B) What could the government do to reduce the natural rate of unemployment. Explain why your action would have the desired effects.

4) (16 points) Answer EITHER Part A OR Part B.

A) Draw the supply and demand for the US\$ on the foreign exchange market versus the C\$. Illustrate an increase in the Canadian interest rates on the diagrams. Explain why the curve(s) moved as drawn. Which currency appreciated? How can you tell?

B) Draw the supply and demand for the US\$ on the foreign exchange market versus the €. Suppose the value of the US\$ is fixed at too low an exchange rate. Draw that. What will automatically happen to the money supply in the USA as a result of the undervaluation? Why will that occur? Show that on the diagram. Explain why the curve(s) moved as drawn.

5) (20 points) Run the regression using the data on Page #5 on [exam3.xls](#) to predict *Imports* as a function of *GDP*, *Price of the Good*, and the *Exchange Rate*. On the spreadsheet, calculate what you would expect the quantity imported if a *GDP* is \$20,000, the *Price* is \$9/unit, and the *Exchange Rate* is ¥20/\$. 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 *Sales* based upon *Income*. 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 1.96. **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 *Sales* to be if the *Income* is 500. Would you rely on this number? Explain your logic.