Wilfrid W. Csaplar Jr., Ph.D. Economics 302 Exam #4 2003/04/30

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 100 points and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. I cannot give a few extra minutes because of the class after ours.

1) (10 points) Answer EITHER part A OR part B.
A) Explain why the BP curve slopes upward.
B) If the current market exchange rate is $1.5/£ and tomorrow it becomes £0.5/$, then did the dollar appreciate, depreciate, revalue, or devalue? Briefly explain your logic.

2) (18 points) Illustrate EITHER the event in part A OR the event in part B on the supply and demand for the Japanese yen (¥) priced in US dollars. Explain why the curve(s) moved as drawn.
A) The interest rates in Japan increase.
B) The GDP in the USA decreases.

3) (20 points) Do EITHER part A OR part B.
A) What is the *Quantity Theory of Money*? Illustrate on the SRAS/LRAS/AD diagram an increase in government spending assuming the quantity theory of money holds. Explain why the curve(s) moved as drawn. If no curve moved, explain why no curved moved.
B) Monetarists assume the velocity of money is constant. Explain their logic. Some economists disagree with that assumption. Why might the velocity of money vary from year to year?

4) (22 points) Friedman's model of money demand is given by $M_d = f(Y_p, w, r_b, r_e, p, \Delta p^e, u)$. Use this to answer EITHER part A OR part B.
A) What are r_e and Δp^e? How do they affect money demand? Why do they have that effect?
B) What are r_b and p? How do they affect money demand? Why do they have that effect?

5) (30 points) Illustrate EITHER the event in part A OR the event in part B on the IS/LM/BP diagram. Continue moving the curve(s) until all three markets are in equilibrium. Explain the movement(s) of the curve(s). Assume the exchange rate is flexible and the BP curve is flatter than the LM curve.
A) There is an increase in the marginal income tax rate.
B) Foreigners start to import more goods.