Wilfrid W. Csaplar Jr., Ph.D. Economics 302 Exam #3 2006/04/20

Write your name on the cover of the test booklet and nowhere else. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. I will give some extra time, but not a lot.

For all questions, just show the short-run effects. Do not worry about the long-run effects.

1) (10 points) Explain EITHER the equation in Part A OR the equation in Part B.
A) $r = f(Y)$. This is the equation for the LM curve.
B) $Y = f(P)$. This is the equation for the AD curve.

2) (12 points) Answer EITHER Part A OR Part B.
A) Give a real world example which explains why changes in *aggregate economic activity* may not cause *co-movements* in the economic activity.
B) The fact that the business cycle is *recurrent but not periodic* is important for economic stabilization through monetary and/or fiscal policy. Explain the reason.

3) (14 points) Answer EITHER Part A OR Part B.
A) Some economists say that in the long-run, an increase in the money supply has no real effect. It only affects nominal variables. Explain the economic reason for this.
B) Some economists say that fiscal policy have no short-run effects on GDP. Explain their logic.

4) (16 points each) For TWO of the following variables, determine if they are pro-cyclical, counter-cyclical, or acyclical. Then determine if they are leading, coincident, or lagging indicators. Explain the economic reasons those variables are characterized as you chose.
A) Inventory investment
B) Stock prices
C) Inflation

5) (16 points) When we drew the IS/LM/FE diagram and the LRAS/SRAS/AD diagram, we said that there were two pairs of lines which were virtually the same line. For ONE of the pairs, state which two lines are similar and explain the economic reason why they are similar.

6) (18 points) Answer EITHER Part A OR Part B.
A) Draw the real money supply and demand diagram. Illustrate an increase in the price level. Explain why the curve(s) moved as drawn. What happens to the variables on the two axes? Why do they change in that manner?
B) Draw the IS/LM/FE diagram. Illustrate an increase in the liquidity of non-monetary assets. Explain why the curve(s) moved as drawn.

7) (48 points) Answer EITHER Part A OR Part B.
A) Draw the IS/LM/FE diagram, SRAS/LRAS/AD diagram, and the real money supply and demand diagram. Illustrate an increase in government spending on all three diagrams. Explain why the curve(s) moved as drawn. What happens to real GDP, real interest rates, and the price level?
B) Draw the IS/LM/FE diagram, SRAS/LRAS/AD diagram, and the real money supply and demand diagram. Illustrate an increase in the money supply on all three diagrams. Explain why the curve(s) moved as drawn. What happens to real GDP, real interest rates, and the price level?