

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 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 12-point question should take 6 minutes. I can give extra time but not much.

1) (10 points) Answer EITHER Part A OR Part B.

- A) The definition of the business cycle says they are “recurrent but not periodic.” What does that mean?
- B) The definition of the business cycle uses the term “aggregate economic activity.” What does that mean?

2) (10 points) Explain EITHER  $r = \alpha_{IS} + \beta_{IS}Y$  OR  $Y = \alpha_{IS} + \beta_{IS}r$ . Note that the former equation is the book’s explanation of the IS curve and the latter equation is my explanation of the IS curve. Do not worry about  $\alpha_{IS}$  and  $\beta_{IS}$ .

3) (12 points) For EITHER the event in Part A OR the event in Part B, determine what happens to M1 and M2. Explain your logic.

- A) You pay for your \$300 textbook with a credit card.
- B) You transfer \$5000 from a CD to your checking account.

4) (12 points) Answer EITHER Part A OR Part B.

- A) If the Fed increases the required reserve ratio, then what will happen to the money supply? Explain your logic.
- B) If the Fed increases the discount rate, then what will happen to the money supply? Explain your logic.

5) (12 points) Answer EITHER Part A OR Part B.

- A) Wealth plays a minor role in the three graphs we discussed (IS/LM/FE, LRAS/SRAS/AD, and real MS/real MD); however three of the lines are directly affected by an increase in wealth. Explain how ONE of those lines is affected. Do not worry about drawing the graph.
- B) Why hasn’t the velocity of money for M1 been stable since around 1980?

6) (14 points each) For TWO of the following variables, determine if it is procyclical, countercyclical, or acyclical. Then determine if it is leading, lagging, or roughly coincident. Explain your logic.

- A) inflation
- B) residential fixed investment
- C) duration of unemployment

7) (18 points) Answer EITHER Part A OR Part B.

- A) There is much ado over whether or not  $V$  is constant. One school says that it may not be constant, but it is predictable. Give the proof that  $V$  is constant. Given your proof, what variable or part of the economy might cause  $V$  to change. Explain your logic.
- B) State the Quantity Theory of Money. Use it to explain the statement which macroeconomists often say, “inflation is a monetary phenomenon.”

**Question #8 is on the back.**

8) (48 points) Answer EITHER Part A OR Part B.

A) Draw the IS/LM/FE, LRAS/SRAS/AD, and real MS/real MD graphs. Illustrate the effects of a decrease in the price of capital. Explain why the curves moved. What happens to real GDP, real interest rates, and the price level?

B) Draw the IS/LM/FE, LRAS/SRAS/AD, and real MS/real MD graphs. Illustrate the effects of a decrease in the price of oil. Explain why the curves moved. What happens to real GDP, real interest rates, and the price level?

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