

Econ 302
Fall 2005

Don't forget to download a copy of the Homework Cover Sheet. Mark the location where you handed in your work.

Homework #4; Chapter 10. This homework has three parts (A, B, C). Each part will be separately graded.

Part A, HW #4, Ch #10.

Go to technical problems, page 266. Do the following problems. Show your work.

- | | | |
|------|------|------|
| 1. a | 2. a | 3. a |
| 1. b | 2. b | 3. b |
| 1. c | 2. c | 3. c |
| 1. d | 2. d | |

Part B, HW#4, Ch #10.

Go to empirical problems, page 267. Do the following problems. Show your work.

- 1.
- 2.

Part C, HW#4, CH#10.

MC Quiz, 25 questions, use red score sheet handed out in class or available outside Heady 281 or Heady 167.

We will use the following grading scale.

- A = 20+
- B = 19, 18, 17
- C = 16, 15, 14
- D = 13, 12, 11
- F = < 11

Name: _____ Date: _____

1. Interest rate changes have an important side effect on the economy since even a small change in interest rates can significantly change
 - A) the composition of output demanded
 - B) the level of private saving
 - C) the level of consumption
 - D) the level of government spending
 - E) none of the above

2. In the IS-LM model, the interest rate serves as a link between
 - A) household saving and business investment
 - B) government spending and consumer spending
 - C) actions of the central bank and changes in consumer spending
 - D) the goods market and the assets market
 - E) domestic markets and foreign markets

3. The level of investment spending is affected by changes in the interest rate, since higher interest rates
 - A) will increase the cost of borrowing and thus lower the incentive to purchase capital equipment
 - B) will make it more profitable to invest in the stock market
 - C) will increase the return on saving
 - D) will lower the value of government bonds so banks will lend more to firms and less to the government
 - E) all of the above

4. If investment becomes more responsive to changes in the interest rate, then
 - A) the size of the government spending multiplier will increase
 - B) a given increase in the interest rate will lead to a larger increase in income
 - C) the IS-curve will become flatter
 - D) the IS-curve will become steeper
 - E) both A) and C)

5. From which of the following equations can the equation for the IS-curve be derived?
 - A) $I + G + NX = S + TA - TR$
 - B) $Y = C + I + G + NX$
 - C) $M/P = kY - hi$
 - D) $MV = PY$
 - E) both A) and B)

6. Which of the following is TRUE as we move along the IS-curve?
- A) a lower interest rate is compatible with a higher equilibrium output level
 - B) a higher equilibrium output level is compatible with a higher interest rate
 - C) a lower equilibrium income level is compatible with a higher transactions demand for money
 - D) a higher interest rate is compatible with a higher level of saving
 - E) a higher interest rate is compatible with higher asset prices
7. We can expect the IS-curve to become flatter as
- A) the supply of money decreases
 - B) the marginal propensity to consume decreases
 - C) the income tax rate increases
 - D) investment becomes more sensitive to interest rate changes
 - E) money demand becomes more sensitive to interest rate changes
8. Which of the following actions will result in a parallel shift of the IS-curve to the left?
- A) an increase in lump sum taxes
 - B) an increase in government purchases
 - C) a decrease in nominal money supply
 - D) a decrease in autonomous saving
 - E) an increase in the income tax rate
9. If there is an increase in the income tax rate, then the IS-curve will
- A) become flatter and shift to the right
 - B) become steeper and shift to the left
 - C) become steeper and shift to the right
 - D) shift parallel to the left
 - E) shift parallel to the right
10. Which of the following is the equation for the IS-curve?
- A) $i = (1/b)A_0 + (b/\alpha)Y$
 - B) $i = (1/b)A_0 - (b/\alpha)Y$
 - C) $i = (k/h)Y + (1/h)(M/P)$
 - D) $i = (k/h)Y - (1/h)(M/P)$
 - E) $L = kY - hi$

11. Any point to the left and below the IS-curve means that
- A) there is excess demand for goods and services in the expenditure sector
 - B) there is excess supply of goods and services in the expenditure sector
 - C) the expenditure sector is in equilibrium but the money sector is not
 - D) there is excess demand in the money sector
 - E) there is excess supply of money in the money sector
12. If the quantity of money demanded exceeds the quantity supplied at the current interest rate, then
- A) bond prices and the interest rate will both rise
 - B) bond prices and the interest rate will both fall
 - C) bond prices will rise and the interest rate will fall
 - D) bond prices will fall and the interest rate will rise
 - E) the value of both stocks and bonds will increase
13. People will hold more money if they expect
- A) bond prices to rise
 - B) yields on bonds to fall
 - C) yields on bonds to rise
 - D) the government budget surplus to increase
 - E) to get paid more frequently
14. The LM-curve
- A) shows the relationship between the interest rate and the level of investment spending
 - B) is negatively sloped because increases in the income level can only be achieved if the interest rate is lowered
 - C) is negatively sloped since increases in money supply always lower interest rates
 - D) is upward sloping because a higher income level is always associated with a higher supply of money
 - E) shows combinations of the interest rate and the income level such that money supply and money demand are equal
15. If we change the assumption that money supply is fixed but instead assume that the amount of money supplied increases as the interest rate increases, then
- A) the LM-curve will become flatter
 - B) the LM-curve will become steeper
 - C) the LM-curve will shift to the left
 - D) monetary policy will be more effective
 - E) both A) and D)

16. If money demand becomes more income elastic, then the LM-curve will
- shift parallel to the right
 - shift parallel to the left
 - become steeper
 - become flatter
 - become flatter and shift to the right
17. Which of the following will result in a parallel shift of the LM-curve to the right?
- an increase in interest rates
 - an increase in autonomous saving
 - an increase in money supply
 - an increase in money demand
 - an increase in investment
18. An increase in the money supply sets in motion a sequence of changes that tend to
- lower interest rates and therefore decrease the level of saving and investment
 - lower interest rates, stimulate investment spending, and increase national income
 - lower interest rates and bond prices and decrease money demand
 - stimulate investment spending, shifting both the LM- and IS-curves to the right
 - increase government spending since more funds become available
19. Which of the following is the equation for the LM-curve?
- $L = kY + hi$
 - $L = kY - hi$
 - $i = (k/h)Y + (1/h)(M/P)$
 - $i = (k/h)Y - (1/h)(M/P)$
 - $i = (1/b)A_0 - (b/\alpha)Y$
20. In an IS-LM model, an increase in money supply will
- increase income, the interest rate and the price level
 - increase income and the price level but decrease the interest rate
 - increase income, decrease the interest rates, and leave the price level unchanged
 - increase income and the price level but leave the interest rate unchanged
 - increase the price level and the interest rate but leave income unchanged
21. In an IS-LM model, an increase in the personal income tax rate will
- lower consumption and the interest rate but increase investment
 - lower consumption and investment but increase the interest rate
 - increase aggregate money demand and therefore cause interest rates to increase
 - increase the expenditure multiplier
 - decrease real money balances

22. Monetary policy becomes more effective as
- A) the interest sensitivity of investment increases
 - B) money demand becomes less sensitive to changes in the interest rate
 - C) the marginal propensity to save decreases
 - D) the income tax rate decreases
 - E) all of the above
23. A movement along the AD-curve from left to right is equivalent to a shift of
- A) the LM-curve to the right due to an increase in real money balances
 - B) the IS-curve to the right due to a decrease in interest rates
 - C) the LM-curve to the right due to an increase in nominal money supply
 - D) the IS-curve to the right due to a lower price level
 - E) both the IS- and LM-curves to the right due to more spending and higher money balances
24. The slope of the AD-curve will become steeper if
- A) money demand becomes more income inelastic
 - B) money demand becomes more interest elastic
 - C) investment becomes more interest elastic
 - D) the income tax rate is decreased
 - E) none of the above
25. Which of the following is the equation for the AD-curve?
- A) $Y = \alpha(A_0 - bi)$
 - B) $Y = (h/k)i + (1/k)(M_0/P_0)$
 - C) $Y = \gamma A - \gamma(b/h)(M_0/P_0)$
 - D) $Y = \gamma A + \gamma(b/h)(M_0/P)$
 - E) $P = (k/h)Y - (1/h)i$