



1. The fallacy of composition

- (a) is also known as the perversity thesis.
- (b) could justify the opinion that policy measures that work well for certain markets may not work well for the whole economy.
- (c) is a particular example of the Laffer curve.
- (d) None of the above

2. Goodhart's law

- (a) constitutes an example of a policy rule.
- (b) is a way of financing the government debt.
- (c) sets limits to what can be accomplished through economic policies.
- (d) is inversely related to the Fisher equation.

3. The expression "supply-side economics" means that

- (a) liquidity is in short supply or that the central bank should supply liquidity.
- (b) the government should supply public services.
- (c) the money supply equals cash plus deposits.
- (d) None of the above

4. The Ricardian equivalence proposition points out some limitations of implementing

- (a) fiscal policies.
- (b) the Swan diagram.
- (c) the business cycle.
- (d) None of the above

5. Demand-pull deflation is deflation caused by

- (a) the balance sheet recession theory.
- (b) an increase in the demand for liquidity.
- (c) a reduction in aggregate demand.
- (d) None of the above

6. Triangular arbitrage is not possible if exchange rates are

- (a) 1 €/\$, 2 €/¥, 1 \$/¥.
- (b) 2 €/\$, 2 €/¥, 1 \$/¥.
- (c) 2 €/\$, ½ €/¥, ½ \$/¥.
- (d) None of the above

7. The expenditure multiplier process

- (a) is another name for the money multiplier process.
- (b) involves feedback between income and consumption.
- (c) occurs only when spatial arbitrage is impossible.
- (d) is the process that makes commercial arbitrage possible.

8. The unemployment rate does not tend to go down when

- (a) the economy is in the expansionary phase of the business cycle.
- (b) the economy is between the trough and the peak of the current business cycle.
- (c) the economy experiences a depression.
- (d) None of the above

9. Which sentence is not false?

- (a) Okun's law is true only when the purchasing power parity theory is false.
- (b) Cost-push deflation is the typical target of fiscal policy.
- (c) The real exchange rate can be smaller than the real interest rate.
- (d) The decision lag of a macroeconomic policy is a good lagging indicator of the unemployment rate.

10. Nominal GDP in economy 1 is larger than nominal GDP in economy 2. The GDP deflator in economy 2 is smaller than the GDP deflator in economy 1. Then, necessarily,

- (a) real GDP in economy 1 is larger than real GDP in economy 2.
- (b) real GDP in economy 1 must be equal to real GDP in economy 2.
- (c) the real exchange rate is equal to 1.
- (d) None of the above

11. If real GDP does not change, then

- (a) the GDP inflation rate is larger than the rate of growth of nominal GDP.
- (b) the sum of the GDP inflation rate and the rate of growth of nominal GDP is approximately zero.
- (c) the GDP inflation rate is approximately equal to the rate of growth of nominal GDP.
- (d) None of the above

12. The euro does not appreciate with respect to the dollar if

- (a) the eurozone interest rate is pushed up.
- (b) the US GDP falls.
- (c) more US tourists visit the eurozone.
- (d) None of the above

13. According to the liquidity market model, what could not explain, in principle, a rise in the interest rate?

- (a) An expansionary open market operation
- (b) An increase in the reserve ratio
- (c) The government issues T-bills massively
- (d) 25% of all the banks go bankrupt

14. What shifts the AS function and the AD function in the same direction, at least initially and in general?

- (a) A contractionary fiscal policy and an increase in the number of firms
- (b) A contractionary monetary policy and an expansionary fiscal policy
- (c) A supply-side policy and a rise in the financial wealth caused by a stock market boom
- (d) A rise in energy prices and a depreciation of the domestic currency.

No answer: no penalty · Wrong answer: -1/3 of the value of a correct answer · Weight: 28%

1	2	3	4	5	6	7	8	9	10	11	12	13	14

DNI number _____ Surnames _____ Name _____

The mark you believe you deserve →

1. [12%] Suppose that the government is not collecting enough revenue to cover its debt payments. To justify an eventual default, the government makes changes in the law so that it is easier for debtors not to pay their debts. Specifically, in some circumstances, borrowers may choose not to repay their loans. (i) Explain and analyze graphically in the liquidity market model the likely effect of this policy measure on the equilibrium interest rate. (ii) Indicate two monetary policy measures that could neutralize the effect on the interest rate found in (i).

2. [3%] The velocity of circulation of money does not change. At the same time, the inflation rate is negative and nominal GDP remains constant. Using the quantity equation, determine whether the money stock rises, falls, or remains unchanged.

3. [2%] State two ideas or views held by orthodox economists and two held by heterodox economists.

Orthodox

Heterodox

4. [2%] Explain the meaning of the expression “austerity economics”.

5. [1%] Indicate a procyclical and a countercyclical macroeconomic variable.

Procyclical

Countercyclical

6. [1.5%] Indicate some feature than Okun’s law and the Phillips curve have in common and some other that differentiates them.

In common

Difference

7. [3%] Explain one of the monetary policy transmission channels.

8. [2%] What is the crowding-out effect?

9. [4%] (i) Write the version of the savings macroeconomic that involves seven variables. (ii) Find savings **S** if the other six variables take the same value $x > 0$.

10. [6%] Imagine that the central bank declares all banknotes no longer valid and that only coins can be used to make cash payments. How is this measure likely to affect the money creation process and the value of the money multiplier?

11. [5%] If possible, find the money multiplier if deposits **D** double the bank reserves **R**, cash **E** is one-fourth of **M1**, and **M0** is twice **E**. If not possible, explain why not.

12. [12%] “Venezuela has been teetering on the brink of default the past two months. The country is barely making enough money on oil exports to cover its debt payments. This year Venezuela owes over \$10 billion in debt payments. Nearly half of that is due in October and November. ‘I’m 99% sure they’re going to default this year,’ says Russ Dallen, managing partner at LatInvest, a Miami-based firm that invests in Venezuela.”

<http://money.cnn.com/2016/01/18/news/economy/venezuela-economy-meltdown/index.html>

Assume that the Venezuelan bolivar is the home currency and the dollar the foreign currency. Assume as well that the currency market is not subject to capital controls. Explain and analyze graphically in the currency market model whether the bolivar should be expected to appreciate or depreciate against the dollar if the Venezuelan government refuses to pay at maturity the face value of T-bills bought by American investors.

13. [12%] The Morawiecki Plan. “‘We want to support more Polish businesses as it’s better to have more local capital. Right now the conditions for international companies are better than those for Polish businesses. In order to attract foreign investment we are paying huge money for some of these projects to come. Over the past several years many Polish companies have felt that they have been treated in a discriminatory way. However, we are not going to discriminate against anybody.’”

<http://www.warsawvoice.pl/WVpage/pages/article.php/28445/article>

Assume that the Polish zloty is the home currency and the euro the foreign currency. Initially, a policy has been implemented to encourage foreign investors to invest in Poland. The new policy is to remove advantages to foreign investors. Explain and analyze graphically in the currency market model the effect of the new policy on the exchange rate.

14. [5%] (i) Assuming the formula that relates the face value of a T-bill, its price, and the interest rate, calculate the discount factor if the price of T-bills is 900 and their face value is 1,200. (ii) Explain what the value of the discount factor represents.

15. [1.5%] According to the relative purchasing parity, what is the rate of appreciation of the euro against the dollar if the European inflation rate is 5% and the US inflation rate is -2%?

16. [1.5%] According to the uncovered interest rate parity, what is the expected rate of appreciation of the euro against the dollar if the European interest rate is 3% and the US interest rate is -1%?

17. [2%] What is incompatible according to the impossible trinity?

18. [1.5%] Calculate the real interest rate if nominal GDP equals the GDP inflation rate.

19. [2%] What is Taylor's rule?

20. [4%] (i) Calculate the real exchange rate (adopting the dollar as the home currency) if the nominal exchange rate is 6 \$/€, the European CPI is 120, and the US CPI is 20. (ii) Calculate also the corresponding purchasing power parity exchange rate.

21. [1.5%] Indicate three supply-side policies.

22. [1.5%] One of the possible explanations for the existence of involuntary unemployment holds that...



23. [7%] “The chart shows the failure of Italy to grow. It is Italy's real gross domestic product on a semi-log scale. The slope matters here, and the slope is ugly. The level is back to around the year 2000 (red circle). Essentially, the economy has gone nowhere for a decade and a half. The extrapolation of the trend shows a huge gap between what could've-should've been and where Italy is now.”
<http://www.bloomberg.com/news/articles/2015-06-16/i-knew-italy-s-economy-was-bad-but-the-truth-may-be-even-grimmer>

(a) In the AS-AD model, what shift in AS function could explain the evolution of Italy's GDP? (b) And what shift in the AD function? (c) Which of the two scenarios is more likely?

24. [15% at least each] (i) “Drought has reduced water levels at Venezuela’s main dam and hydroelectric plant in Guri to near-critical levels. The dam provides for about two-thirds of the nation’s energy needs. Water shortages and electricity cuts have added to the hardships of Venezuela’s 30 million people...”

http://www.huffingtonpost.com/entry/venezuela-energy-2-day-work-week_us_5720bb05e4b01a5ebde403ce

Using the AS-AD model, explain and analyze graphically the effect on the macroeconomic equilibrium of the existence of a drought and the subsequent reduction in the activity of hydroelectric plants.

(ii) “Venezuela’s socialist government ordered public workers on Tuesday to work a two-day week as an energy-saving measure in the crisis-hit South American OPEC country. President Nicolas Maduro had already given most of Venezuela’s 2.8 million state employees Fridays off during April and May to cut down on electricity consumption. ‘From tomorrow, for at least two weeks, we are going to have Wednesdays, Thursdays and Fridays as non-working days for the public sector,’ Maduro said on his weekly television program. Full salaries will still be paid despite the two-day week.”

http://www.huffingtonpost.com/entry/venezuela-energy-2-day-work-week_us_5720bb05e4b01a5ebde403ce

(a) Using the AS-AD model, explain and analyze graphically the effect on the macroeconomic equilibrium of passing a law that declares that firms must close down four days every week. (b) Does it make any difference if firms must pay workers for the whole week or just for the three days that they work for the firms?

(iii) “Gross domestic product in the world's third-largest economy [Japan] grew at an annualised pace of 1.7%. The better-than-expected growth rate came after higher government spending helped to offset weakness in business investment and exports.”

<http://www.bbc.com/news/business-36319420>

(a) Represent in the AS-AD model the effect on the macroeconomic equilibrium of experiencing “weakness in business investment”.
(b) Do the same if the weakness refers to exports.

(iv) “In January [2016], the Bank of Japan introduced negative interest rates in an attempt to stimulate the economy. ‘One of the lessons over the past year is that monetary policy isn’t as effective as it was in the past and might have reached some limits,’ Martin Schulz from Fujitsu Research Institute told the BBC. ‘So what we will probably see this year is that the Bank of Japan will keep buying government bonds and the government will probably start to spend even more than it did before to support the economy.’ ”
<http://www.bbc.com/news/business-36319420>

(a) Explain how a negative interest rate is supposed to stimulate the economy.

(b) In what sense “monetary policy isn’t as effective as it was in the past”? Which policy targets is monetary policy not so effective to achieve? Interpret the claim that monetary policy might have reached some limits. Which are those limits?

(c) What kind of macroeconomic policy is “keep buying government bonds”? What kind of macroeconomic policy is that the government will “start to spend even more than it did before”? How does additional spending by the government manage to “support the economy”?

(d) Using the AS-AD model, explain and analyze graphically the effect on the macroeconomic equilibrium of: (1) the central bank buying more government bonds; and (2) the government spending more.

(v) Abenomics. “Japanese Prime Minister Shinzo Abe's economic policy, which quickly became known as ‘Abenomics’ is based on three arrows:

The monetary arrow: expansion of the money supply to combat deflation.

The fiscal arrow: increased government spending to stimulate demand in the economy.

The structural arrow: structural reforms to make the economy more productive and competitive.”

<http://www.bbc.com/news/business-36319420>

Use the AS-AD model to explain how each arrow is supposed to produce the stated effects.

(vi) “Spain and Portugal will get only one extra year to fulfil EU fiscal rules on their deficits, once sanctions against both countries are adopted, while Italy will escape an infringement procedure.”

<http://www.euractiv.com/section/euro-finance/news/commission-to-punish-spain-and-portugal-pardon-italy-on-deficits/>

Using the AS-AD model, consider the economies of Spain and Italy. Suppose that Spain is forced to reduce government spending and Italy is not. (a) Determine the effect of that measure on the macroeconomic equilibrium of Spain. (b) Ascertain the likely indirect effect of the measure on Italy’s macroeconomic equilibrium, identifying clearly the variables that link the two economies.

(vii) The European Commission 2016 country-specific recommendations. “As external factors supporting Europe's moderate recovery are fading, domestic sources of growth are gaining in importance. Today's recommendations therefore focus on the Commission's three priority areas: Investment is still low compared to pre-crisis levels but is gaining traction, also helped by the Investment Plan for Europe. Faster progress on structural reforms is necessary to boost the recovery and raise the long-term growth potential of EU economies. All Member States need to pursue responsible fiscal policies and ensure growth-friendly composition of their budgets.”

http://europa.eu/rapid/press-release_IP-16-1724_en.htm

(i) Use the AS-AD model to analyze the impact on the macroeconomic equilibrium of each of the three recommendations: boosting investment, implementing structural reforms, and pursuing fiscal responsibility. (ii) Could any of these policies be considered a supply-side policy?

(viii) The Morawiecki Plan. “Poland’s [...] government approved a long-term economic development plan [...]. The plan aims to boost industry, innovation and exports [...]. The program [...] is based on five pillars: reindustrialization, innovation, international expansion, sustainable social and regional development, and increased savings. It largely reflects the ruling party’s campaign pledge to generate a flood of new investment for enhanced growth. ‘The Polish economy has been growing for 27 years and our growth drivers have petered out,’ Morawiecki says. He adds that the country needs to change its growth pattern after years of relying on ‘an unsustainable level of debt, EU aid, CO2 cost exemptions, demographic conditions, low wages and low innovation.’ ‘We envisage a wise strengthening of industrialization with an increase in output,’ Morawiecki says. The government wants to achieve this aim through moves such as creating new competitive advantages for Polish businesses. One of the development ministry’s aims is to harness capital accumulated by enterprises. The government should create investment-friendly conditions to encourage businesses to invest.” <http://www.warsawvoice.pl/WVpage/pages/article.php/28445/article>

Using the AS-AD model, explain and analyze graphically the effect on the macroeconomic equilibrium of the above plan, identifying clearly which measures would constitute supply-side, and which ones demand-side, policies.