Intermediate Macroeconomics

ECON 302

Sample Midterm Exam

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Instructions:

This paper is divided into two sections. You should attempt 3 short questions from Section A and 1 long question from Section B. Section A has a weight of 45% (15% weight per question); Section B has a weight of 55%.

Please be **concise** in your answers. **Answer ONLY what the question asks**, as points are not awarded for verbosity! You should limit your answers to each question in section A to 1 side of a US letter sized paper. For most questions, you should find that you are able to answer the questions with a short paragraph. For section B, please limit your answer to 3 sides (US Letter sized paper).

In terms of a general hint to try and maximize points*, try to relate the context of the questions to any of the models that we have studied in lectures*. Where appropriate, use graphs and equations to help elucidate your answer! You may use the lecture notes and the textbook. Please sign the agreement below before turning in the exam.

Agreement: All of the work on this exam has been done independently, without consulting any other students in this class or faculty in other classes. As presented in class, the essays may be done with a referral to formulae, but all of the written material in the essay is original, "synthetic" independent work, with no copying of published or unpublished material. I attest that this exam has not been copied or distributed in any part or form.

Name: _______________________________________; Student Id#: ___________________________

Signature: ______________________________________; Date: ___________________________

Section A - Short Questions [15 points each]

Answer **THREE** of the following five questions. Provide brief, clear answers along with your reasoning. Marks are awarded for the clarity and specificity of your arguments in each of the questions. Relate the context of the questions to any of the models you have studied in the lectures, using graphs and equations to elucidate your answers as necessary. [Hint: To increase your marks, reread the question along with your answer to see if you have answered what the question has asked.]

1. Consider your basic IS-LM model at a long-run equilibrium. Suppose that there is a reduction in the budget deficit. What does this mean? Describe the effects of this reduction in both the short run and the long run on interest rates, output and prices giving economic intuition for the changes.

2. What is meant by a "Liquidity Trap"? Under a Liquidity Trap, output is independent of prices. Suppose that there are real balance effects present. Describe the economic intuition for what happens when there is an increase in the supply of money, i.e. does it have an impact on output, and if so, how? If it does not have an impact on output, what happens?

3. "The Fisher equation implies that the best predictor of inflation is the nominal interest rate". Do you agree? Why or why not?

4. What effect does an increase in the expected rate of inflation have on the level and composition of aggregate demand, holding prices fixed? Under what circumstances will this expected inflation effect be neutral in terms of its effect on economic activity?

5. Suppose that a financial innovation makes the demand for money more interest-elastic. How does this affect the relative efficacy of monetary and fiscal policy?

Section B - Long Questions [55 points]

Answer **ONE** of the following two questions. Marks are awarded for **clarity** and **specificity** of your answers as well as how you **communicate** the thesis of your argument. Be sure to relate the context to any applicable models you have studied in lectures. Use graphs and equations to elucidate your answers as necessary.

6. Consider one of the four models used to explain the short run aggregate supply curve. Explain what happens in the labor market if there is a negative shock to demand that leads to a fall in prices. How does the real wage behave?

7. What are the main competing explanations for the Great Depression? Discuss to what extent each hypothesis is consistent with the facts. How could monetary and fiscal policies have been used to combat that recession and what might make you prefer the use of monetary rather than fiscal policy, or *vice versa*?