

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 100 points and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. I cannot give a few extra minutes because of the class after ours.

1) (10 points) Explain how a decrease in interest rates will affect EITHER the balance of trade OR investment.

2) (14 points) Do EITHER part A OR part B.

A) Suppose that the equation for consumption is given by  $C = 100 + 0.8Y_D$ . What are the MPC and the APS if the disposable income is given by  $Y_D = 1000$ ? Show all work and briefly explain what you did.

B) What is unplanned inventory investment? What will happen to the economy in the future when there is unplanned inventory investment now? BRIEFLY explain your logic.

3) (16 points) Use the IS/LM diagram to illustrate EITHER an increase in the MPC OR an increase in the marginal tax rate. Explain why the curve(s) moved as drawn.

4) (16 points) Do EITHER part A OR part B.

A) Illustrate an increase in the liquidity of assets like bonds on the supply and demand diagram for money. Explain why the curve(s) moved as drawn.

B) Illustrate an increase in the price level on the IS/LM diagram. Explain why the curve(s) moved as drawn.

5) (16 points) Do EITHER part A OR part B.

A) Japan is in a Keynesian liquidity trap now. The interest rates on 2-year government bonds are about 0.05%. Their M1 has grown at around 33% in the past year and M2 has grown at about 8%. Explain why M1 has grown faster than M2. Hint: what will cause M1 to grow, but not change M2?

B) What is meant by *standard of measure* and *unit of account*? Give an example of how the money supply could satisfy one of those properties without satisfying the other.

6) (28 points) Suppose that the following equations hold for our economy.  $C = 100 + 0.8(Y-T)$ ,  $T = 0.3Y$ ,  $I = 250 + 0.1Y$ ,  $G = 300$ ,  $X = 150$ , and  $M = 0.16Y$ . Calculate the autonomous expenditure multiplier, the MPS, and the APS. Show all work and briefly explain what you did.