

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 (to be scaled up to 160 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. Because of classes after yours, I cannot give extra time.

1) (14 points) Explain EITHER the equation in Part A OR the equation in Part B.

A)  $r = \alpha_{LM} - (1/\ell_r)(M/P) + \beta_{LM}Y$ . Only explain  $M/P$  and  $Y$ .

B)  $M^d/P = \ell_0 + \ell_Y Y - \ell_r(r + \pi^e)$ . You can treat  $r + \pi^e$  as one variable. Do not explain the  $\ell$ s.

2) (14 points) EITHER explain why the AD curve takes its shape, OR explain why the IS curve takes its shape.

3) (14 points) Answer EITHER part A OR Part B.

A) The definition of a recession includes the phrase *recurrent but not periodic*. What does that mean?

B) In my opinion, the theory implies that the business cycle should be less severe now than it was prior to World War II.

4) (16 points) For EITHER *inventory investment* OR *employment*, determine if it is pro-cyclical, counter-cyclical or acyclical. Is it leading, lagging, or roughly coincident? Explain your logic for both parts.

5) (42 points) Draw the SRAS/AD/LRAS diagram, IS/LM/FE diagram, and the real MS/real MD diagrams. Illustrate the effects of EITHER an increase in government spending OR an increase in the money supply on all three graphs. Explain why the curves moved as drawn. What happens to GDP, the price level, and the interest rates? Use the same event for all three graphs.