

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. I cannot give extra time because I have a class after your class.

- 1) (10 points) Explain EITHER the LM equation  $r = \alpha_{LM} + \beta_{LM}Y$  or the AD equation  $Y = \alpha_{AD} - \beta_{AD}P$ .
- 2) (14 points) For EITHER *inventory investment* OR *new unemployment claims*, determine if it is pro-cyclical, counter-cyclical, or acyclical. Explain your logic. Do you think that variable is a leading, lagging, or roughly coincident variable? Explain your logic.
- 3) (14 points) Illustrate EITHER the effects of the event in Part A OR the effects of the event in Part B on the real MS/ real MD diagram. Explain why the curve(s) moved as drawn. What happens to the real money supply and the real interest rate?
  - A) The Federal Reserve sells bonds.
  - B) The price level increases
- 4) (20 points) Answer EITHER Part A OR Part B.
  - A) Draw the LRAS/SRAS/AD diagram with the economy in a recessionary gap. Illustrate what will happen in the long-run to bring the economy back to equilibrium. Explain why the curve(s) moved as drawn. State the long-run effects on the price level and GDP.
  - B) State the neutrality of money. Draw the IS/LM/FE diagram. Use it to explain why the neutrality of money may happen. Make sure you explain the movement(s) of the curve(s).
- 5) (42 points) For EITHER the event in Part A OR the event in Part B, illustrate the effects of the event on the SRAS/LRAS/AD diagram, IS/LM/FE diagram, and the real MS/real MD diagram. Explain why the curves moved as drawn. What happens to price level, interest rate, real GDP, and real money supply? Label the old and new values of those variables on the graphs.
  - A) The Federal Reserve increases the required reserve ratio.
  - B) The marginal propensity to consume increases.

**Monday's class will be in Old Main 109.  
Remember to fill out course evaluations.**