

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 150 points (to be scaled up to 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can give extra time, but not a lot.

1) (12 points) Answer EITHER Part A OR Part B.

A) Why have business cycles become longer and less severe since World War II?

B) Why are some economists uncertain that the cycles have become less severe?

2) (12 points) EITHER explain why the velocity of money should be constant OR why the velocity of  $M1$ ,  $V1$ , has not been stable.

3) (12 points) Explain EITHER the equation in Part A OR the equation in Part B. Ignore the constants  $a$  and  $b$ .

A) LM:  $r = a + bY$

B) IS, my explanation:  $r = a - bY$

4) (16 points) For each of the following determine if it is procyclical, acyclical, or countercyclical. Explain your logic. Is it leading, lagging, or roughly coincident? Explain your logic. Since neither of these is in your textbook, I will grade your answers leniently.

A) Ratio of consumer debt to personal income.

B) New residential building permits.

5) (18 points) Answer EITHER Part A OR Part B.

A) Draw the LRAS/SRAS/AD diagram with the economy in an inflationary gap. Explain how you know it is an inflationary gap. Illustrate the effects of the economy moving back to full employment without government intervention. Explain why the curve(s) moved as drawn. What happens to the price level, real GDP, and the unemployment rate?

B) Draw the LRAS/SRAS/AD. Illustrate the effects of an increase in the price of oil. Explain why the curve(s) moved as drawn. What happens to the price level, real GDP, and the unemployment rate?

6) (18 points) Draw the IS/LM/FE diagram. Illustrate the effects of EITHER the event in Part A OR the event in Part B. Explain why the curve(s) moved as drawn. What happens to the real interest rate and real GDP?

A) The marginal propensity to save increases.

B) The Fed sells bonds.

7) (18 points) Answer EITHER Part A OR Part B.

A) Draw the real MS/MD diagram. Use it to explain the neutrality of money.

B) Draw the real MS/MD diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to the real money supply and the real interest rate?

8) (44 points) Draw the LRAS/SRAS/AD, IS/LM/FE, and real MS/real MD diagrams. Illustrate the effects of EITHER the event in Part A OR the event in Part B on all three graphs. Use the same event for all three graphs. Explain why the curves moved as drawn. What happens to the price level, interest rates and real GDP?

A) The price of capital goes up.

B) The stock market crashes.