MACROECONOMICS

Section II

Planning Time—10 minutes

Writing Time—50 minutes

Directions: You have 50 minutes to answer all three of the following questions. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. Use a pen with black or dark blue ink.

1. Assume that declining stock market prices in the United States cause many United States financial investors to sell their stocks and increase their money holdings.

   (a) Draw a correctly labeled graph of the money market and show the impact of the financial investors' actions on each of the following.

      (i) Demand for money

      (ii) Nominal interest rate

   (b) Due to the decline in wealth caused by the change in stock prices, the general price level in the United States falls relative to the price level in Japan, a trading partner. Use a correctly labeled graph of the foreign exchange market for the United States dollar to show the impact of the change in relative price levels on each of the following.

      (i) Demand for the dollar

      (ii) Price of the dollar (yen/dollar)

   (c) How will the change in the price of the dollar you indicated in part (b) (ii) affect net exports of the United States? Explain.

   (d) Using a correctly labeled aggregate demand and aggregate supply graph, show how the change in net exports in part (c) will affect each of the following in the short run.

      (i) Aggregate demand

      (ii) Output and price level

   (e) Given your answers to part (d), what will happen to unemployment in the short run? Explain.

GO ON TO THE NEXT PAGE.

2. In recent years, the Federal Reserve has made targeting the federal funds rate a main focus of its monetary policy.
   (a) Define the federal funds rate.
   (b) If the Federal Reserve wants to lower the federal funds rate, what open-market operation would be appropriate?
   (c) Assume that the open-market operation that you indicated in part (b) is equal to $10 million. If the required reserve ratio is 0.2, calculate the maximum change in loans throughout the banking system.
   (d) Indicate the effect of the open-market operation that you indicated in part (b) on the nominal interest rate.
   (e) Assume that the Federal Reserve's action results in some inflation. What would be the impact of the open-market operation on the real rate of interest? Explain.

3. Indicate whether each of the following is counted in the United States gross domestic product for the year 2006. Explain each of your answers.
   (a) The value of a used textbook sold through an online auction in 2006
   (b) Rent paid in 2006 by residents in an apartment building built in 2000
   (c) Commissions earned in 2006 by a stockbroker
   (d) The value of automobiles produced in 2006 entirely in South Korea by a firm fully owned by United States citizens

STOP

END OF EXAM