

UNIVERSITY OF FORT HARE

Macro Economics
ECO 221/E

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Subject: ECO 221/E

Marks: 100

This paper consists of 6 pages including the cover page

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INSTRUCTIONS

This question paper is made up of three sections.

Answer **ALL** questions in section **A**.

Answer **ALL** questions in section **B**.

Choose **ANY TWO** questions from section **C**.

Multiple Choice Questions

1. Under a fixed exchange rate system, the central bank must allow the money supply to adjust
 - a. to keep interest rates and exchange rates unchanged.
 - b. have an unlimited supply of domestic currency.
 - c. have a very large supply of foreign assets.
 - d. follow a constant money growth rule.

2. If money demand is not responsive to changes in interest rates, then
 - a. the LM curve will become vertical.
 - b. the IS curve determines equilibrium output.
 - c. the LM curve is vertical.
 - d. the LM curve will become horizontal.

3. The position of the Keynesian aggregate demand schedule does not depend on the
 - a. price of inputs such as oil.
 - b. level of government spending.
 - c. quantity of money.
 - d. level of autonomous investment expenditures.

4. Which of the following is not a function of the SARB?
 - a. control the required reserve ratio.
 - b. control the amount of commercial lending in the banking system.
 - c. serve as a lender to commercial banks.
 - d. conduct purchases and sales of government bonds.

5. The Phillips Curve illustrates the trade-off between:
 - a. Inflation and unemployment
 - b. Inflation and interest rates
 - c. Government spending and taxation
 - d. Investment and consumption

6. Measuring the rate of inflation using a market basket that excludes food and energy prices is preferred by some analysts because this measure, called core inflation,
 - a. fluctuates more than measures of inflation that include food and energy prices.
 - b. gives a better measure of ongoing, sustained price changes.
 - c. is more consistent with measures of inflation used in other countries.
 - d. provides a real, rather than a nominal, rate of inflation.

7. In the IS-LM model, if interest rates rise while output falls the
 - a. level of government spending must have fallen.
 - b. money supply must have risen.
 - c. price level must have fallen.
 - d. money supply must have fallen.

8. The short-run Phillip curve shifts when there is a change in there is a change in
- technology.
 - money demand
 - the expected price levels.
 - the labor force.
 - all of the above
9. The portion of the money supply controlled by a central bank is
- currency.
 - deposits.
 - reserves.
 - the monetary base.
10. In the classical model, what adjusts to eliminate any unemployment of labor in the economy?
- the real wage
 - the average price level
 - the interest rate
 - the real rental price of capital
11. The BP schedule will be steeper the
- less likely an expansionary fiscal policy will lead to a balance of payments deficit.
 - more responsive capital flows are to the interest rate.
 - less responsive capital flows are to the interest rate.
 - smaller the marginal propensity to import.
12. The Fisherian version of the quantity theory equation is
- $MV = Py$.
 - $y = c + i + g$.
 - $M = kPy$.
 - $s = i + (g - t)$.
13. In an economy with perfect capital mobility, if domestic interest rates are above world interest rates then
- the central bank will have to intervene even if exchange rates are floating.
 - capital inflows will drive domestic interest rates down.
 - current account deficits will drive domestic interest rates down.
 - capital outflows will drive domestic interest rates down.
14. The increased willingness of women to enter the workforce has most likely lead to
- a decrease in labor demand, lower real wages, and no effect on the price level.
 - an increase in labor supply, higher real wages, and a lower price level.
 - an increase in labor demand, higher real wages, and a lower price level.
 - an increase in labor supply, higher real wages, and a higher price level.
15. The supply-determined nature of output and employment is a crucial feature of
- the Keynesian theory.
 - the classical system.
 - monetarism.
 - the rational expectations model.

16. Which of the following are endogenous variables within the classical model?
- quantity of money
 - output
 - technology
 - level of capital
17. Traditional Keynesians tend to favor
- fiscal policy over monetary policy because of the liquidity trap.
 - monetary policy over fiscal policy because of the effectiveness of central banks.
 - monetary policy over fiscal policy because it reduces interest rates.
 - fiscal policy over monetary policy because it doesn't impact interest rates.
18. Real gross domestic product (GDP) means the value of goods and services is measured in _____ prices.
- average
 - actual
 - current
 - constant
19. Monetary policy will be
- more effective with a vertical IS curve.
 - equally effective regardless of whether or not the interest elasticity of investment is higher or lower, or the IS curve is flatter or steeper.
 - more effective the higher the interest elasticity of investment, the flatter the IS schedule.
 - less effective the higher the interest elasticity of investment, the steeper the IS schedule
20. In the Mundell-Fleming model, the exogenous variables are
- the world interest rate, the price level, and the exchange rate.
 - the price level, the world interest rate, monetary policy, and fiscal policy.
 - the exchange rate and the price level.
 - government spending, taxes, and income.
21. The BP curve shifts to the left when
- Imports increase.
 - The exchange rate falls.
 - Interest rates rise.
 - Income rises.
22. Diminishing marginal returns refers to the fact that
- the returns to labor fall as real wages rise.
 - holding other inputs constant, additional increases in labor lead to lower output.
 - additional increases in labor always lead to smaller changes in output.
 - holding other inputs constant, additional increases in labor lead to smaller changes in output.
23. According to the Keynesians, labor contracts
- imply that nominal wages adjust, but only periodically.
 - mean that money wages never adjust.
 - mean that real wages are inflexible.
 - are unimportant for modern labor markets because few worker are unionized.

24. Gross national product (GNP) equals gross domestic product (GDP) _____ income earned domestically by foreigners _____ income that nationals earn abroad.

- a. plus; minus
- b. plus; plus
- c. minus; minus
- d. minus; plus

25. The largest component of national income is:

- a. net interest
- b. compensation of employees
- c. corporate profits
- d. proprietors income

SECTION B: (COMPULSORY)

[25]

Question 1 [15]

- a. The SARB uses several tools to control bank reserves. Name and briefly explain any two instruments. [4]
- b. Explain the difference between the CPI and GDP deflator measures of inflation. Which one is likely to measure inflation higher? Why? [5]
- c. What is meant by wage rigidity? Briefly discuss three sources of wage rigidity that have led to Keynes' adopting a contractual view of the labour market. [6]

Question 2 [10]

- a. What two principles of mercantilism did the classicists attack? [2]
- b. In an open economy, which market is depicted by the LM, IS, and BOP curves? [3]
- c. Briefly explain the difference between flexible and fixed exchange rates. What exchange rate regime is South Africa using? [5]

SECTION C: (ANSWER ANY TWO QUESTIONS FROM THIS SECTION)

[50]

Question 1 [25]

- a. Compare and contrast the Cambridge and Fisher versions of the quantity theory of money. Why is the Cambridge approach considered to be a more modern theory of money demand? [10]
- b. Illustrate and explain the effect of an expansionary fiscal policy under a flexible exchange rate regime with perfect capital mobility. [15]

Question 2 [25]

- a. Describe the impact of the size of the multiplier (MPS) on the slope of the IS curve. [5]
- b. Illustrate and explain the effects of an increase in the quantity of money on the IS-LM model [10]
- c. Illustrate and explain the effects of an autonomous decrease in investment according to the Classicalist Approach. [10]

Question 3 [25]

1. What impact do you think the movement of women from working in the household to working in the market has had on GDP? Why? Do you think that this points to a problem with GDP? Explain your answer. [3]
2. Evaluate Keynes's definition of money demand. What were the three motives for holding money? Briefly discuss these motives. [9]
3. With the help of the Phillips curve, explain the impact of high interest rates on unemployment, inflation, and output. [13]

END OF EXAMINATION PAPER