CHAPTER 14

1. Let the consumption, tax, and import functions be



Let us take exports and investment as exogenous. What is the multiplier with respect to investment?

1. Approximately 0.9
2. Approximately 1
3. Approximately 1.1
4. Approximately 1.2
5. Approximately 1.3

2. Suppose that the multiplier with respect to exports is 4/3, the price elasticity of exports is 3 and exports constitute 1/5 of GDP. By how much will aggregate demand decrease if there is a one percent real appreciation of the currency?

1. 0.6 percent
2. 0.7 percent
3. 0.8 percent
4. 0.9 percent
5. 1 percent

3. From the point of view of macro policy in the small open economy, which of the following regimes is most similar to membership of a monetary union?

1. A fixed exchange rate and a strictly inflation targeting central bank
2. A flexible exchange rate and strictly inflation targeting central bank
3. A fixed but adjustable exchange rate
4. A strictly fixed exchange rate

4. Which of the statements below is correct?

1. Comparing the IS and IS\* curves we see that IS\* is steeper because it takes account of the effect of the interest rate on the exchange rate
2. Comparing the IS and IS\* curves we see that IS\* is flatter because it takes account of the effect of the interest rate on the expected exchange rate
3. Comparing the IS and IS\* curves we see that IS is steeper than IS\* because the IS curve does not take account of the effect of the interest rate on net exports
4. Comparing the IS and IS\* curves we see that IS\* is flatter because it takes account of the effect of the exchange rate on the interest rate

5. With a flexible exchange rate and unchanged money supply, what is the short-run effect of an increase in government consumption?

1. A decrease in private investment and net exports and an ambiguous effect on private consumption
2. A decrease in private investment, net exports, and private consumption
3. A decrease in private investment and private consumption while net exports remain unchanged
4. An increase in private investment and private consumption while net exports decrease

6. What statement best characterizes a strict flexible exchange rate regime?

1. The central bank does not react to movements in the exchange rate
2. The central bank is not allowed to take account of the exchange rate when making monetary policy decisions
3. The central bank has no explicit target for the exchange rate
4. The central bank has no explicit or implicit target for the exchange rate

7. The figure below illustrates a situation where production is on the natural level and inflation is equal to the inflation target **.

i

IS

Y

IP

*Yn*

e

**

*Y*

**

*PC*

LM

Now the government decides to increase government consumption. This may lead to “crowding out” of private investments. In which case is this “crowding out” effect largest?

1. When the money supply is kept unchanged
2. When the interest rate is kept unchanged
3. When the central bank has a strict inflation target
4. When the exchange rate is kept unchanged

8. What is the short run effect of an increase in the *foreign* interest rate if the domestic interest rate is kept unchanged?

1. The exchange rate depreciates and production decreases
2. The exchange rate appreciates and production decreases
3. The exchange rate depreciates and production increases
4. The exchange rate appreciates and production increases

9. A country has a flexible exchange rate and a strict inflation target. Production is on the natural level and inflation is on the target level. How would you expect the central bank to react to an increase in the foreign interest rate?

1. The central bank cuts the interest rate
2. The central bank trades foreign currency for monetary base
3. The central bank raises the interest rate
4. The central bank tries to reduce the value of the currency

10. What is a typical “operation in the currency market”?

1. The central bank trades domestic government bonds for monetary base
2. The central bank trades foreign currency for bank monetary base
3. The central bank trades domestic government bonds for foreign currency assets
4. The central bank trades domestic notes and coins for foreign notes and coins