

Must know questions (exam 2 version)

1. Definition and significance questions: go to D2L, content browser, under econ terms.
2. Suppose that the Fed's policy objective is to keep the nominal interest rate (i) constant. How would a Fed with this policy objective respond to a decrease in money demand? Why? Illustrate your answer with diagrams of the money and bond markets.
3. Why are there so many interest rates?
4. Assume (a) the economy is initially in equilibrium at noninflationary full-employment GDP (y^*) (b) government spending is cut by \$10 billion (c) taxes are cut by \$10 billion and (d) the $MPC=.8$

Using your knowledge of the government spending and tax multipliers, calculate the change in Y caused by the decrease in government spending then calculate the change in Y caused by the decrease in taxes.

Using a PTE/ASK and J/W, illustrate and briefly explain the combined effects of the spending and tax cuts. What, if any, problem would be the economy be experiencing after these fiscal policy changes?

5. Give the three reasons to explain why there are so many different interest rates?
6. Consider the following: "In the late 1920s, the FED decided to slow down the booming stock market by raising interest rates.

Use the quantity theory of money to explain the likely effects of this fed policy on the overall or general price level (P).

Using diagrams of the money and bond markets, illustrate and explain the likely effects of this FED policy.

7. Use the quantity theory of money to explain deflation/ inflation.
8. If you were a member of the FED, what three policies could you suggest to combat inflation/ deflation? Explain each policy

Using money and bond market diagrams, illustrate and briefly explain the effects of your suggested open market policy.

9. Three functions of money

10. Suppose Congress decides to cut taxes by \$12 billion. Then it also decides to cut government spending by \$12 billion.

Assuming $MPC=0.8$, calculate the combined effects of these actions on nominal GDP (Y). Show your calculation.

Suppose Congress undertakes these actions in an attempt to reduce inflationary pressures in the economy. Does it succeed? Why or why not?