Monmouth COLLEGE

- Name: ______________________
- Date: ______________________

ECON 301 Intermediate Macroeconomics

Quiz #5

Spring 2024

INSTRUCTIONS:

- Please read all questions carefully before you begin answering.
- Answer all questions in the spaces provided on the question sheet.
- This quiz consists of 7 pages, including this one. There are a total of 5 problems with a total of 15 subquestions.
- This is a closed-book quiz. Please remove all materials from the top of the desk and take any necessary items from your bags before the exam begins.
- The estimated recovery rate for this quiz is 50%.

THIS PAGE IS INTENTIONALLY LEFT BLANK

Problem 1. Definitions **(5 Points Each)**

Select FOUR items on the list of items below, and provide a definition of the items that you chose.

- Net Exports
- Real Exchange Rate
- Nominal Exchange Rate
- Interest Rate Parity
- Demand for Domestic Goods
- Domestic Demand for Goods

1.A. Item #1: ______________________________

1.B. Item #2: ______________________________

1.C. Item #3: ______________________________

1.D. Item #4: ______________________________

Problem 2. True / False **(5 Points Each)**

Determine whether the following statements are either `TRUE` or `FALSE`. If you deem that the statement is `TRUE`, there is no need to justify your answer. If you deem that the statement is `FALSE`, you MUST justify your verdict by providing an explanation.

2.A. The effect of a tax cut on domestic output will be greater when the economy is open, compared to when the economy is closed.

2.B. Even when an economy's production matches its potential output, its net exports may not necessarily be zero.

2.C. If the amount of Euros required to purchase 1 US dollar changes from 1 to 1.2, we say that the US dollar has appreciated against the Euro.

2.D. When the real exchange rate of an economy depreciates, both its exports and imports tend to increase.

Problem 3. Short Answers: Exchange Rates and Interest Rates (7.5 Points Each)

Suppose that a US investor with a \$100 budget faces two potential investment opportunities; purchasing US bonds, or purchasing UK bonds. US bonds are denominated in US dollars (\$), and UK bonds are denominated in Pound sterling (£). Suppose that the nominal exchange rate E is currently 1.

3.A. If the investor invests their entire budget on US bonds that guarantee a 5% annual return, how much in US dollar (\$) terms would the investor have at the end of the year?

3.B. If the investor invests their entire budget on UK bonds that guarantee a 10% annual return, how much in Pound sterling (£) terms would the investor have at the end of the year?

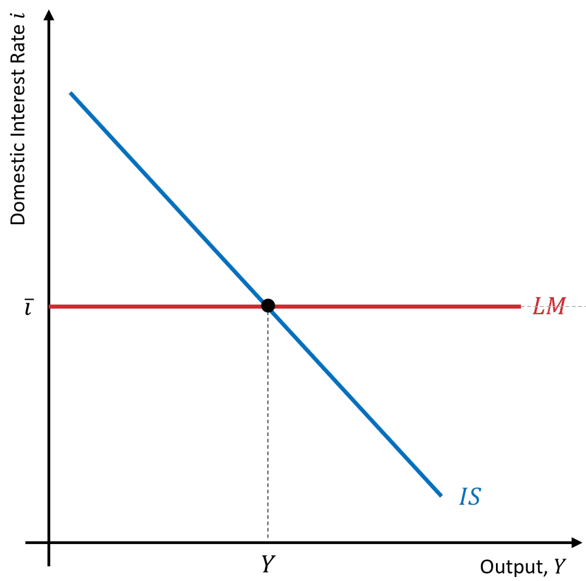
3.C. Suppose that by the end of the year, the nominal exchange rate has appreciated to $E = 1.05$. How much in US dollar (\$) terms would the investor who invested in UK bonds have at the end of the year?

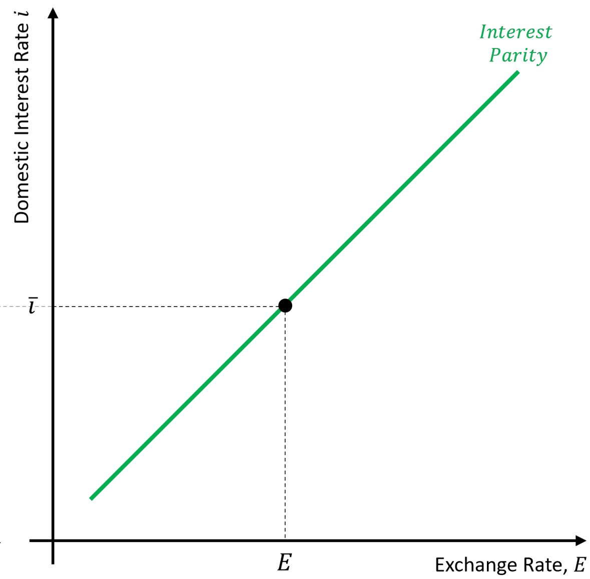
3.D. Based on your answers from 3.A. to 3.C., should the investor invest in the US bonds with a 5% annual return, or the UK bonds with a 10% annual return?

Problem 4. Short Answers: Monetary Policy in an Open Economy **(10 Points Each)**

Consider an open economy that is operating beyond its potential output (that is, $Y > Y_n$).

4.A. The Fed is concerned that the output gap will lead to higher inflation, which could result in the de-anchoring of expectations in the economy. Illustrate in the following graph the changes in the economy that will occur if the Fed conducts contractionary monetary policy.





4.B. Based on your answer from 4.A., what happens to...

- ...the domestic interest rate? (increases / decreases / does not change)

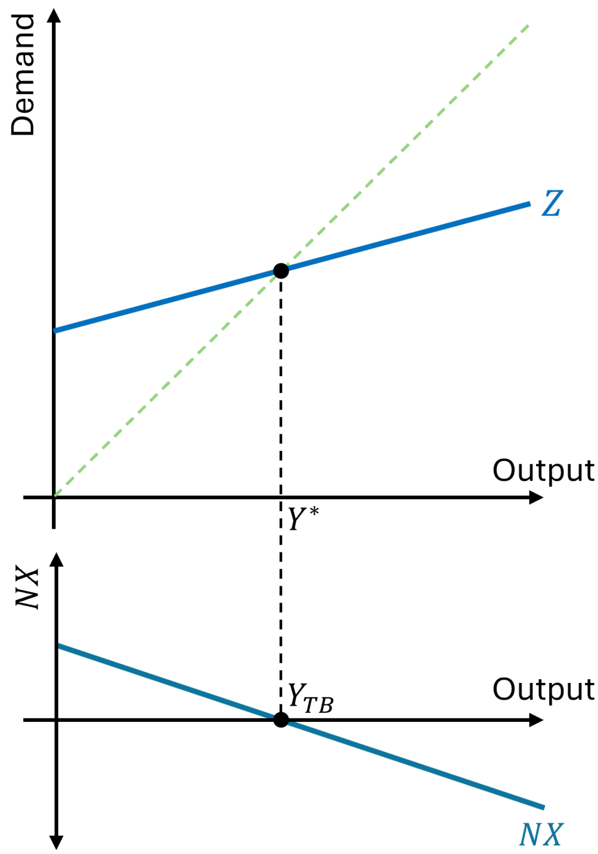
- ...the nominal exchange rate? (appreciates / depreciates / does not change)

- ...the balance of trade? (improves / worsens / does not change)

Problem 5. Short Answers: Fiscal Policy and Trade Balances **(10 Points)**

Suppose that the economy is operating at the medium-run equilibrium, which happens to coincide with the balanced trade level of output.

5.A. Complete the following graph by illustrating the effect of a tax cut and explain its effect on the country's balance of trade (remains in balance? deficit? surpus?).



- Original Score: ____________
- Recovered Score: ____________
- Original Date: ____________
- Recovered Date: ____________