Instructions

1. Use a #2 pencil to mark the following in the answer sheet.
   - Mark your last name, your first name and your student identification number.
   - As the section number, mark “0001” if you are enrolled in the 9:00 section.
     Mark “0002” as the section number if you are enrolled in the 10:30 section.
   - Mark “01” as the test/quiz number.

2. Write your name on the space provided in the top left corner of every page of the question sheet.
Part I (30 points)

**Instruction:** Answer whether the following statements are true or false. If you answer true, mark “A” in the answer sheet. Mark “B” otherwise. (1 point each)

1. A temporary fall in margin propensity to consume in a small-open economy increases the national saving in the short run.
2. A temporary fall in margin propensity to consume in a small-open economy increases the real interest rate in the short run.
3. When countries run current account surpluses, they are net exporters in the world goods market.
4. When countries run current account surpluses, they are net exporters in the world capital market.
5. An open-market sale of government bonds increases the monetary base for a given level of money multiplier.
6. An open-market purchase of government bonds increases the money multiplier.
7. In the long run, a rise in inflation expectations raises the nominal interest rate.
8. In the long run, countries with higher money growth rate than output growth rate experience an increase in the price level.
9. In the long run, countries with higher money growth rate than output growth rate experience an increase in the velocity of money.
10. A temporary increase in oil price causes the the Phillips curve to shift upward for a short period.
11. A temporary increase in oil price causes the the AS curve to shift upward for a short period.
12. The central bank can stabilize both output and inflation in response to a temporary fall in net exports by using a temporary money expansion.
13. The central bank can stabilize both output and inflation in response to a temporary fall in net exports by using a temporary money contraction.
14. The central bank can stabilize both output and inflation in response to a temporary oil shock by using a temporary money expansion.
15. The central bank can stabilize both output and inflation in response to a temporary oil shock by using a temporary money contraction.
16. Without Ricardian Equivalence, a temporary fiscal expansion has the same qualitative impact on inflation as a temporary monetary expansion.

17. Without Ricardian Equivalence, a temporary fiscal expansion has the same qualitative impact on output as a temporary monetary expansion.

18. Without Ricardian Equivalence, a temporary fiscal expansion has the same qualitative impact on exchange rate as a temporary monetary expansion.

19. With Ricardian Equivalence, the fiscal multiplier is equal to the money multiplier.

20. With Ricardian Equivalence, a payroll tax cut has a positive effect on output.

21. With Ricardian Equivalence, a capital gain tax cut has a positive effect on output.

22. Under a flexible exchange rate system, a permanent increase in the inflation rate in the US causes the dollar to appreciate in the long run.

23. Under a flexible exchange rate system, a temporary increase in the US interest rate causes the dollar to appreciate in the short run.

24. Under a flexible exchange rate system, an anticipation about a temporary rise in the US interest rate causes the dollar to appreciate in the short run.

25. Under a fixed exchange rate system, maintaining free capital mobility implies that the central bank must sacrifice independent monetary policy.

26. Under a fixed exchange rate system, a rise in the foreign interest rate reduces the foreign exchange reserves.

27. Consider the two-period model of consumption with preferences for consumption smoothing. Households whose current income is higher than future income become borrowers.

28. Consider the two-period model of consumption with preferences for consumption smoothing. A rise in the real interest rate causes households to increase current consumption.

29. Consider the two-period model of consumption with preferences for consumption smoothing. A rise in current income causes households to increase current consumption.

30. Consider the two-period model of consumption with preferences for consumption smoothing. A rise in future income causes households to increase current consumption.
Part II (70 points)

Instruction: Answer the following questions and depict diagrams as required.

1. (10 points) What is inflation tax? How is it collected? How does it influence the central bank’s balance sheet?
2. (10 points) Suppose consumers in Mexico permanently reduce demand for US goods. Use the AD-AS model to explain effects of this event on output and inflation rate in the US, in both the short run and the long run. Next, assume that the US central bank follows the Taylor rule. Use the MP curve to explain the effect of this event on the US real interest rate in the short run and in the long run.
3. (10 points) Suppose the goal of central banking is to stabilize output and inflation. Suppose that a hurricane has damaged oil refineries in the south, and it takes 6 months to repair them. Can the US central bank achieve its goal by using monetary policy? Use the AD-AS model to explain your reasons.
4. (10 points) The US central bank engaged in a permanent money contraction in 1980-1986. Use the AD-AS model to explain effects of this event on inflation and unemployment in the US in both the short run and the long run.
5. (10 points) The Obama administration responded to the recent financial crisis by a large-scale temporary fiscal stimulus, but the unemployment rate is still higher than the level before the crisis. Some economists have proposed that the ineffectiveness of the fiscal stimulus is caused by Ricardian Equivalence and a supply-side tax cut is a better alternative. Do you agree with them? Explain your reasons using the AD-AS model.
6. (10 points) The US central bank responded to the recent financial crisis by successive rounds of money expansion. Suppose that past money expansions caused the public to anticipate further money expansions in the future. Explain short-run effects of this anticipation on the yen-dollar exchange rate and Japan’s trade balance. Can Japan’s central bank prevent the yen-dollar exchange rate from changing? If yes, how? Display a diagram to illustrate the foreign exchange market equilibrium.
7. (10 points) Use the Phillips curve framework to explain the time inconsistency problem in monetary policy? How is that related to rational expectations?