UNIVERSITY OF SWAZILAND

FACULTY OF SOCIAL SCIENCES

DEPARTMENT OF ECONOMICS

SUPPLEMENTARY EXAMINATION

JULY 2017

TITLE OF PAPER:	**PRINCIPLES OF MACROECONOMICS**
COURSE CODE:	**ECO 102/ ECO 104/ ECON 104/ IDE**
TIME ALLOWED:	**2 HOURS**
INSTRUCTIONS:	**ANSWER QUESTION ONE (1) AND ANY TWO (2) OTHER QUESTIONS**
	QUESTION ONE CARRIES 40 MARKS
	THE REST OF THE QUESTIONS CARRY 30 MARKS EACH

SECTION A: COMPULSORY **[40]**

PART 1: MULTIPLE CHOICE

1. If the central bank wishes to increase the interest rate in the economy, it should implement
   a. An expansionary monetary policy, which involves the selling of bonds by the central bank on the open market to decrease the money supply.
   b. A contractionary monetary policy, which involves the buying of bonds by the central bank on the open market to increase the money supply.
   c. A contractionary monetary policy, which involves the selling of bonds by the central bank on the open market to decrease the money supply.
   d. An expansionary monetary policy, which involves the buying of bonds by the central bank on the open market to increase the money supply.

2. Which of the following statements is/are true about the classical quantity theory of money?
   a. The equation of exchange is MV = PQ
   b. The classical economists assumed that V would rise when real interest rates rise
   c. The classical economists concluded that increases in the money supply cause increases in real GDP and nothing else
   d. All of the above

3. The monetary authority in Swaziland attempts to attain its monetary policy objectives through changes in
   a. Government spending
   b. The exchange rate
   c. Taxation
   d. The discount rate

4. Which one of the following is **not** an example of an automatic stabiliser?
   a. Unemployment benefits
   b. Social welfare payments
   c. Progressive income taxes
   d. Salaries paid to public servants

5. John had an income of E20, 000 in 2015 and paid E10, 000 in tax. Last year, he had an income of E100, 000 and paid E30, 000 in tax. The tax is:
   a. Progressive
   b. Regressive
   c. Proportional
   d. Ad valorem

6. Which of the following events would shift the short-run aggregate supply curve to the right?

a. An increase in government spending
b. An increase in price expectations
c. A drop in oil prices
d. A decrease in the money supply

7. In the money market model, an increase in the interest rate
   a. Increases the quantity demanded of money
   b. Increases the demand for money
   c. Decreases the quantity demanded of money
   d. Decreases the demand for money

8. Which of the following policy combinations would consistently work to increase the money supply?
   a. Sell government bonds, decrease reserve requirements, decrease the discount rate
   b. Sell government bonds, increase reserve requirements, increase the discount rate
   c. Buy government bonds, increase reserve requirements, decrease the discount rate
   d. Buy government bonds, decrease reserve requirements, decrease the discount rate

9. Which one of the following will result in a decrease in the price level and an increase in the level of income in the AD-AS framework?
   a. An increase in government spending
   b. An increase in productivity
   c. A decrease in the interest rate
   d. An increase in the prices of factors of production

10. A decrease in the reserve requirement causes
    a. Reserves to rise
    b. Reserves to fall
    c. The money multiplier to rise
    d. The money multiplier to fall

11. If government spending is higher than current government revenue, this is known as:
    a. A deficit on the current account of the balance of payments
    b. The budget deficit
    c. The public debt
    d. Good fiscal management

12. If the exchange rate is $0.50 = E5, then a car that sells for $16 000 in the United States will cost_____________.
    a. E80 000
    b. E16 000
    c. E12 800
    d. E160 000
    e. E64 000

13. A depreciation in the value of the Lilangeni on the foreign exchange market is most likely to lead to:
    a. A fall in the Swazi price of imported goods
    b. A rise in the foreign price of Swazi exports of sugar
    c. A higher demand for imported laptops into Swaziland
    d. A higher demand for Swazi exports of textiles and apparel

14. Suppose the Central Bank purchases a government bond from Martha who deposits the entire amount from the sale in her bank. If the bank holds some of the deposit as excess reserves, the money supply will
    a. Rise less than the money multiplier would suggest
    b. Rise more than the money multiplier would suggest
    c. Fall less than the money multiplier would suggest
    d. Fall more than the money multiplier would suggest

15. An increase in the money supply causes:
    a. Interest rates to fall, investment spending to rise, and aggregate demand to rise
    b. Interest rates to rise, investment spending to rise, and aggregate demand to rise
    c. Interest rates to rise, investment spending to fall, and aggregate demand to fall
    d. Interest rates to fall, investment spending to fall, and aggregate demand to fall

16. The three main tools of monetary policy are
    a. Government expenditures, taxation, and reserve requirements
    b. The money supply, government purchases, and taxation
    c. Coin, currency, and demand deposits
    d. Open market operations, reserve requirements, and the discount rate

17. Which of the following represents an action by the Central Bank that is designed to decrease the money supply?

(i) An increase in the discount rate
(ii) Selling government bonds in the open market
(iii)A decrease in the required reserves ratio
(iv)A transfer of government funds from the Central Bank to a commercial bank
(v) An increase in the amount of excess reserves held by banks

    a. (i) and (ii) are correct only
    b. (ii) and (iii) are correct only
    c. (i), (ii) and (v) are correct only
    d. (i), (ii), (iii) and (iv) are correct only
    e. (i), (ii), (iv) and (v) are correct only

18. The combination of fiscal policies that would reinforce each other and be most expansionary would be a(n):

a. Increase in government spending and taxes
b. Decrease in government spending and taxes
c. Decrease in government spending and an increase in taxes
d. Increase in government spending and a decrease in taxes
e. An increase in the interest rate

19. According to the quantity theory of money, an increase in the nominal money supply will lead to:
    a. A stable velocity of money because both prices and output remain unchanged.
    b. An increase in real output and the general price level because an increase in the money supply increases aggregate demand.
    c. Inflation because real output remains unchanged while the velocity of money is stable.
    d. No change in nominal output because real output is determined by labour and capital.
    e. An increase in the velocity of money because there is inflation and real output increases.

20. An increase in consumer wealth will:
    a. Shift the AD to the left
    b. Result in no shift in the AD curve and a downward movement along a single AD curve
    c. Result in no shift in the AD curve and an upward movement along a single AD curve
    d. Shift the AD curve to the right
    e. Have no impact upon the AD curve

PART 2: DEFINITIONS

Align these definitions to the key terms

Natural rate of unemployment, Cyclical unemployment, Labor force, Labor force, participation rate, Discouraged workers, Structural unemployment, Union, Collective bargaining, Strike, Insiders, Outsiders, Right to work laws, Efficiency wages, Adverse selection, Moral hazard, Frictional unemployment, Sectorial shifts, Unemployment insurance, Inflation, Unemployment, Macroeconomics, Microeconomics, Total income, Total expenditure, Gross Domestic product, Intermediate production, Final production, Gross National Product, Depreciation, Investment, Government purchases, Net Exports, Transfer payments, Real GDP, Nominal GDP, Base year, GDP deflator, Recession

i. The production of services valued at current year prices
ii. Spending by households on goods and services, excluding new housing
iii. Spending on domestically produced goods by foreigners (exports) minus spending on foreign goods by domestic residents (imports)

iv. Period of decline in GDP

v. Market value of all final goods and services produced within a country in a given period of time

vi. Wages, rent and profit

vii. The rate at which prices are rising

viii. Market value of all final goods and services produced by a nation's residents in a given period of time

ix. Spending on capital equipment, inventories and structures, including household purchase of new housing

x. Spending on goods and services by all levels of government

xi. Percent of the labour force that is out of work

xii. The study of how households and firms make decisions and how they interact in markets

xiii. Goods produced by one firm to be further processed by another firm The study of an economy wide phenomena

xiv. The production of goods and services valued at base year prices

xv. Finished products sold to the end user

xvi. Consumption, investment, government purchases, and net exports

xvii. The year from which prices are used to measure GDP

xviii. Workers who stop looking for work due to an unsuccessful search

xix. The total number of workers which is the sum of the employed and unemployed

xx. Amount by which exports exceed imports

SECTION B

QUESTION ONE

(a) Suppose that the price level is constant and that there is an increase in investment.

i. How would you show this increase in the aggregate expenditure model? [6]

ii. What would be the outcome for real GDP? [2]

iii. How would you show this increase in investment in the AD-AS model? [7]

(b) Explain the intuition of the multiplier effect resulting from an increase in government spending. Why should a bigger MPC make the multiplier effect larger? [5]

(c) Explain why taxes and government spending may act as automatic stabilizers. What would a strict balanced-budget rule cause policymakers to do during recession? Would this make the recession more or less severe? [5]

(d) What causes both the short-run and long-run AS curves to shift together? What causes only the short-run AS curve to shift while the long-run AS curve remains stationary? [5]

QUESTION TWO

(a) Explain why the AD curve is downward sloping by referring to the

i. Real balances effect [5]

ii. Interest rate effect [5]

iii. International trade effect [5]

(b) (i) Explain the three approaches to measuring GDP [10]

(ii)Explain how these approaches would lead to the same result [5]

QUESTION THREE

(a) Consider a country called wonderland in which there are only two sectors: households and businesses. There is no government and foreign sector. Consumers consume goods and services to the value of E 100 million even if income is zero, and they consume 75% of each additional E 1 that they receive in income. Businesses spend E 200 million in the form of investment spending.

i) Explain how people can consume goods and services even if their income is zero. [3]

ii) Based on this information, derive the consumption function for Wonderland. [2]

iii) Calculate the level of consumption if income is equal to [4]

- Zero
- E100 million
- E400 million
- E800 million

iv) Derive the savings function of wonderland. [3]

v) Calculate the level of saving in Wonderland if income is equal to: [4]

- Zero
- E100 million
- E400 million
- E800 million

vi) Calculate the equilibrium level of income for Wonderland using the aggregate expenditure approach. [4]

(c) Compare and contrast the Classical and the Keynesian schools of thought [10]