***Macroeconomics, 13e* (Parkin)**
Chapter 12 The Business Cycle, Inflation, and Deflation

1 The Business Cycle

1) Business cycle events that arise solely from aggregate demand shifts are emphasized by the
A) Keynesian and real business cycle theories.
B) monetarist and real business cycle theories.
C) Keynesian and monetarist cycle theories.
D) none of the major theories.
Answer: C
Topic: Aggregate Demand Theories of the Business Cycle
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2) Which of the following are business cycle theories that regard fluctuations in aggregate demand as the factor that is creating business cycles?
I. Keynesian cycle theory
II. real business cycle theory
III. monetarist cycle theory
A) I only
B) I and II
C) I and III
D) I, II and III
Answer: C
Topic: Aggregate Demand Theories of the Business Cycle
Skill: Recognition
Status: Revised
AACSB: Reflective thinking

3) Which of the following is NOT an aggregate demand, mainstream theory of the business cycle?
A) Keynesian cycle theory
B) monetarist cycle theory
C) new Keynesian cycle theory
D) real business cycle theory
Answer: D
Topic: Aggregate Demand Theories of the Business Cycle
Skill: Recognition
Status: Old
AACSB: Reflective thinking

4) In 2008, when a recession started, the growth of government expenditures on goods and services doubled compared to its growth in 2007. According to the aggregate demand theories of the business cycle
A) government expenditure was at least a partial cause of the recession.
B) government expenditure was not a cause of the recession.
C) government expenditure was definitely the cause of the recession.
D) None of the above answers are correct because aggregate demand theories of the business cycle focus only on investment and consumption expenditure.
Answer: B
Topic: Aggregate Demand Theories of the Business Cycle
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

5) In the Keynesian business cycle theory, business cycles begin with changes in
A) inflation expectations.
B) consumer sentiment.
C) business confidence.
D) the public's expectations about Fed policies.
Answer: C
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

6) The ________ states that the main source of economic fluctuations is volatile business confidence.
A) real business cycle theory
B) new classical cycle theory
C) Keynesian cycle theory
D) monetarist cycle theory
Answer: C
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

7) Fluctuations in business confidence is the factor leading to business cycles in the
A) Keynesian cycle theory.
B) new Keynesian cycle theory.
C) new classical cycle theory.
D) monetarist cycle theory.
Answer: A
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

8) The factor leading to business cycles in the Keynesian model is
A) changes in business confidence.
B) a speed up in money growth.
C) unanticipated changes in aggregate demand.
D) unanticipated changes in aggregate supply.
Answer: A
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

9) The Keynesian explanation of the business cycle is based on
A) the inability of government policy-makers to predict the future course of the economy.
B) shifts in monetary policy undertaken by the Federal Reserve.
C) fluctuations in business confidence.
D) unstable inflationary expectations.
Answer: C
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

10) The factor that leads to business cycles within the Keynesian cycle theory is
A) the growth rate of labor productivity.
B) the growth rate of the quantity of money.
C) adverse shocks to international trade.
D) fluctuations in business confidence.
Answer: D
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

11) Keynes used the term "animal spirits" to represent
A) changes in people's consumption expenditures.
B) the ease of forecasting.
C) fluctuations in business confidence.
D) investment based on hard facts about the future.
Answer: C
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

12) Which theory emphasizes frequent changes in investment because of "animal spirits" as the main source of economic fluctuations?
A) real business cycle theory
B) new classical cycle theory
C) Keynesian cycle theory
D) monetarist cycle theory
Answer: C
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

13) One model of the business cycle claims that volatile business confidence is the primary factor in starting a business cycle. This model is the
A) real business cycle model.
B) Keynesian cycle theory.
C) aggregate supply model.
D) new classical theory.
Answer: B
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

14) Which theory assumes that business cycles occur because of changes in business confidence?
A) monetarist cycle theory
B) real business cycle theory
C) new classical cycle theory
D) Keynesian cycle theory
Answer: D
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

15) Which of the following describes the Keynesian approach to the business cycle?
I. Unanticipated shocks to aggregate supply drive expansions and recessions.
II. The Keynesian theory is a real business cycle model of the economy.
III. A decrease in business confidence can trigger a recession.
A) I only
B) III only
C) I and II
D) II and III
Answer: B
Topic: Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

16) Suppose that managers forecasted a large decline in expected sales and profits and so their confidence plummets. According to the ________, this forecast might start a business cycle.
A) Keynesian cycle theory
B) circular flow theory
C) monetarist cycle theory
D) new classical cycle theory
Answer: A
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

17) Keynesians believe that
A) money wage rate adjustments will quickly eliminate unemployment.
B) aggregate demand changes tend to induce aggregate supply changes, offsetting any effect from changes in government expenditures.
C) the economy will normally operate at full employment.
D) a change in business confidence can affect the amount of investment in the economy.
Answer: D
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

18) The Keynesian explanation of the business cycle rests on several concepts, including
A) rigid money wage rates.
B) unstable monetary policy by the Fed.
C) shocks to the rate of technological change.
D) the desire of politicians to be re-elected.
Answer: A
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

19) Based on the Keynesian theory of the business cycle, if the economy is at its full-employment equilibrium and aggregate demand increases then
A) the price level and real GDP both increase.
B) the price level rises but real GDP remains unchanged.
C) the price level and real GDP both decrease.
D) real GDP decreases and the price level remains unchanged.
Answer: A
Topic: Keynesian Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

20) For monetarists, the main cause of economic fluctuations is represented by changes in
A) investment.
B) consumption expenditure.
C) the growth rate of the quantity of money.
D) the levels of household debt.
Answer: C
Topic: Monetarist Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

21) The monetarist theory of the business cycle regards ________ as the factor that leads to business cycles.
A) unexpected increases in aggregate demand
B) changes in the growth rate of the quantity of money
C) volatility in the interest rate
D) volatility in the demand for money
Answer: B
Topic: Monetarist Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

22) What, according to the monetarist theory of the business cycle, leads to changes in real GDP?
A) a change in profit expectations
B) a change in the growth rate in tax revenue
C) a change in the growth rate of the quantity of money
D) an unanticipated change in aggregate demand
Answer: C
Topic: Monetarist Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

23) In the monetarist business cycle theory, the factor leading to a business cycle is changes in
A) consumer spending.
B) investment spending.
C) the growth rate of the quantity of money.
D) net exports.
Answer: C
Topic: Monetarist Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

24) In the monetarist business cycle theory, decreasing the growth rate of the quantity of money ________ and increasing the growth rate of the quantity of money ________.
A) increases real GDP; decreases the inflation rate
B) decreases real GDP; decreases the inflation rate
C) causes the economy to enter a recession; causes the economy to enter an expansion
D) causes the economy to enter an expansion; causes the economy to enter a recession
Answer: C
Topic: Monetarist Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

25) In the monetarist business cycle theory, increases in money growth temporarily ________ real GDP and ________ the price level.
A) increase; rise
B) increase; lower
C) decrease; rise
D) decrease; lower
Answer: A
Topic: Monetarist Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

26) Using the monetarist model, place the following events in the order in which they occur in a business cycle.
I. Money wages fall and the *SAS* curve shifts rightward.
II. The Federal Reserve decreases the growth rate of the quantity of money.
III. The *AD* curve shifts leftward.
A) II, III, I
B) III, II, I
C) I, III, II
D) The events are not part of a monetarist model of the business cycle.
Answer: A
Topic: Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

27) Suppose the growth rate of the quantity of money increased from 5 percent per year to 8 percent per year. According to the ________, this event would trigger a business cycle expansion.
A) Keynesian cycle model
B) real business cycle model
C) aggregate supply cycle model
D) monetarist cycle model
Answer: D
Topic: Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

28) Which of the following is <u>TRUE</u> regarding the monetarist theory of the business cycle?

I. Monetarists assume that the quantity of money increases at a constant rate.

II. Fluctuations in interest rates cause business cycles.

III. Changes in the growth rate of the quantity of money affect aggregate demand.

A) I only

B) III only

C) I and II

D) II and III

Answer: B

Topic: Monetarist Theory

Skill: Conceptual

Status: Old

AACSB: Reflective thinking

29) Which of the following pieces of evidence is most consistent with the monetarist theory?

A) Labor supply decisions do not seem to depend on real interest rates.

B) Changes in real GDP and the quantity of money move closely together.

C) Money wage rates take some time to adjust to price changes.

D) Productivity and GDP move closely together.

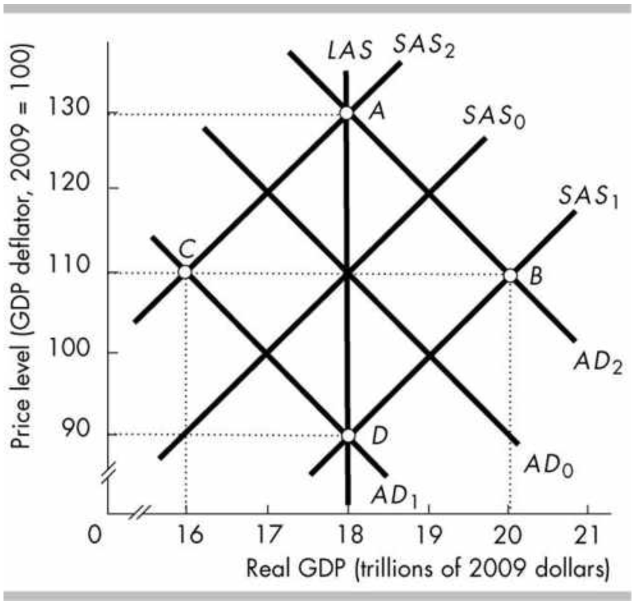
Answer: B

Topic: Monetarist Theory

Skill: Conceptual

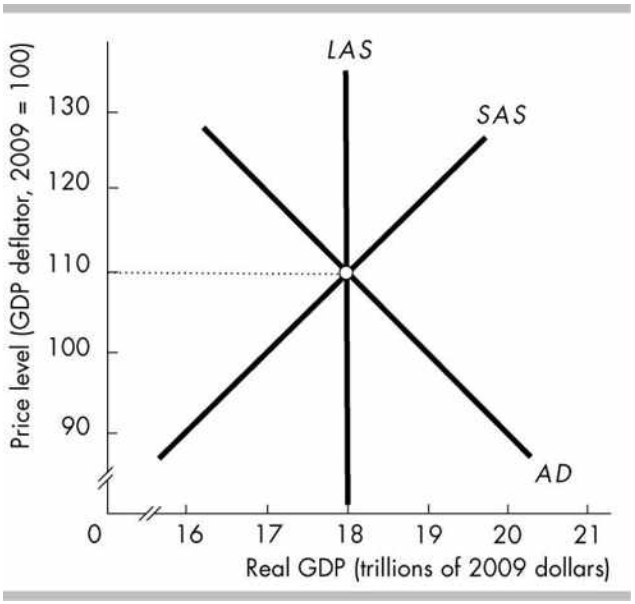
Status: Old

AACSB: Reflective thinking



30) In the above figure, suppose that the economy has moved from point *A* to point *C*. According to the monetarist theory of the business cycle, what could have caused this movement?
A) an increase in the money wage rate
B) an increase in the growth rate of the quantity of money
C) a decrease in the growth rate of the quantity of money
D) an increase in uncertainty
Answer: C
Topic: Monetarist Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

31) In the above figure, suppose that the economy has moved from point *D* to point *B*. According to the monetarist theory of the business cycle, what could have caused this movement?
A) a decrease in the money wage rate
B) an increase in uncertainty about future sales and profits
C) an increase in the growth rate of the quantity of money
D) an increase in the money wage rate
Answer: C
Topic: Monetarist Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking



32) Using the above figure as a starting point, a recession in the monetarist model would begin with a

A) rightward shift in the *AD* curve.

B) leftward shift in the *AD* curve.

C) leftward shift in the *SAS* curve.

D) leftward shift in the *LAS* curve.

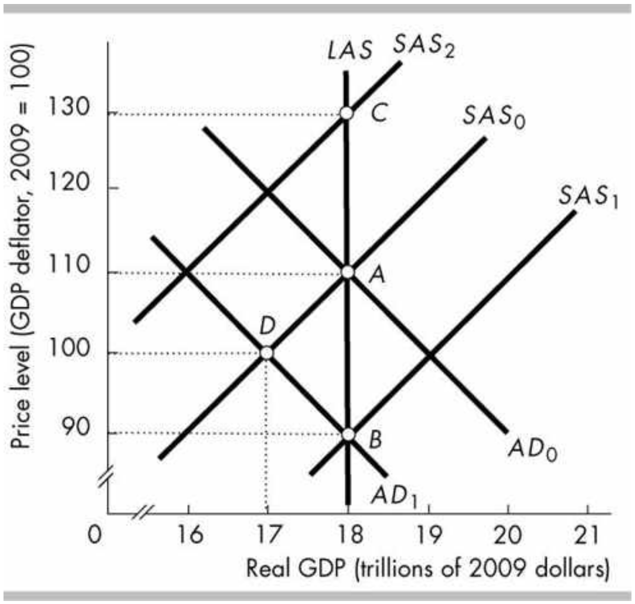
Answer: B

Topic: Monetarist Theory

Skill: Analytical

Status: Revised

AACSB: Analytical thinking



33) In the above figure, the economy is initially at point *A*. According to the monetarists, which point best represents the consequence of a short-run response to a decrease in the growth rate of the quantity of money?

A) *A*, that is, there is no change.

B) *B*

C) *C*

D) *D*

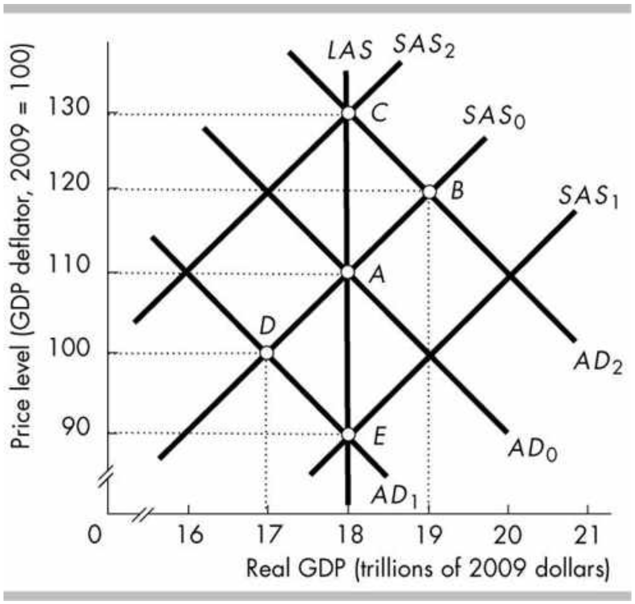
Answer: D

Topic: Monetarist Theory

Skill: Analytical

Status: Revised

AACSB: Analytical thinking



34) In the above figure, suppose the economy starts at point *A*. The short-run response to a decrease in the growth rate of the quantity of money in the monetarist business cycle theory moves the economy to point
A) *B*.
B) *C*.
C) *D*.
D) *E*.
Answer: C
Topic: Monetarist Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

35) In the above figure, suppose the economy starts at point *A*. The short-run response to an increase in the growth rate of the quantity of money in the monetarist business cycle theory moves the economy to point
A) *B*.
B) *C*.
C) *D*.
D) *E*.
Answer: A
Topic: Monetarist Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

36) In the above figure, suppose the economy starts at point *A*. The short-run response to an increase in the growth rate of the quantity of money in the monetarist business cycle theory is for the price level to ________ and real GDP to ________.
A) fall to 90; remain at $18 trillion
B) rise to 120; increase to $19 trillion
C) rise to 130; remain at $18 trillion
D) remain at 110; remain at $18 trillion
Answer: B
Topic: Monetarist Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

37) The new classical cycle theory predicts that an unexpected increase in aggregate demand ________ create a business cycle and an expected increase in aggregate demand ________ create a business cycle.
A) will; will
B) will; will not
C) will not; will
D) will not; will not
Answer: B
Topic: Rational Expectation Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

38) The ________ cycle theory states that only unexpected fluctuations in aggregate demand are the main source of business cycles.
A) new Keynesian
B) new classical
C) Keynesian
D) monetarist
Answer: B
Topic: New Classical Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

39) The business cycle impulse in the new classical theory of the business cycle is
A) unexpected changes in aggregate demand.
B) expected changes in aggregate demand.
C) fluctuations in money growth with rigid wages.
D) fluctuations in investment coupled with rigid wages.
Answer: A
Topic: New Classical Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

40) The new classical theory argues that the primary factor leading to business cycles are
A) expected changes in aggregate demand.
B) expected changes in aggregate supply.
C) unexpected changes in aggregate demand.
D) unexpected changes in aggregate supply.
Answer: C
Topic: New Classical Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

41) Which theory distinguishes between expected and unexpected fluctuations in aggregate demand and argues that only unexpected changes can affect real GDP?
A) new classical cycle theory
B) Keynesian cycle theory
C) monetarist cycle theory
D) real business cycle theory
Answer: A
Topic: New Classical Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

42) According to the new classical model, changes in aggregate demand change real GDP
A) all of the time.
B) only when the short-run aggregate supply curve is vertical.
C) only when the changes in aggregate demand are expected.
D) only when the changes in aggregate demand are unexpected.
Answer: D
Topic: New Classical Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

43) Suppose that forecasters have incorrectly estimated aggregate demand. According to the ________, this mistake could trigger a business cycle.
A) Keynesian cycle model
B) monetarist cycle model
C) new classical cycle model
D) real business cycle model
Answer: C
Topic: New Classical Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

44) A larger than expected increase in aggregate demand will lead to ________ in the ________ of the business cycle.
A) a recession; new Keynesian cycle theory
B) a recession; new classical cycle theory
C) an expansion; new classical cycle theory
D) an expansion; real business cycle theory
Answer: C
Topic: New Classical Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

45) Which of the following CORRECTLY describes the new classical cycle theory of the business cycle?
A) An unexpected change in the quantity of money can trigger a business cycle.
B) An expected tax rate change can trigger a business cycle.
C) An unexpected change in the price of oil can trigger a business cycle.
D) Rational expectations keep the money wage from changing quickly.
Answer: A
Topic: New Classical Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

46) One assumption of the new classical model is that
A) money wage rates are rigid.
B) prices are "sticky" upward.
C) people have rational expectations about aggregate demand.
D) markets are not purely competitive.
Answer: C
Topic: New Classical Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

47) Both new Keynesian and new classical cycle theories claim that
A) animal spirits can trigger a business cycle.
B) shifts in the *SAS* curve are the main impulse for a business cycle.
C) unexpected changes in aggregate demand trigger a business cycle.
D) expected changes in the quantity of money can trigger a business cycle.
Answer: C
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

48) Both the new classical and new Keynesian business cycle theories agree that
A) expected changes in aggregate demand lead to the business cycle.
B) unexpected changes in aggregate demand cannot result in a business cycle.
C) the money wage rate is influenced by rational expectations of the price level.
D) the long-term nature of wage contracts allow expected changes in the price level to cause business cycles.
Answer: C
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

49) A key DIFFERENCE between the new classical and the new Keynesian views of the business cycle is the role played by
A) unexpected changes in aggregate demand.
B) government expenditure on goods and services.
C) expected changes in aggregate demand.
D) the growth rate of the quantity of money.
Answer: C
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

50) The key difference between the new classical theory of the business cycle and the new Keynesian theory of the business cycle is that the new classical theory believes that ________ while the new Keynesian theory believes that ________.
A) expected changes in aggregate demand will change real GDP; expected changes in aggregate demand will not change real GDP
B) only unexpected changes in aggregate demand will change real GDP; only expected changes in aggregate demand will change real GDP
C) only unexpected changes in aggregate demand will change real GDP; both expected and unexpected changes in aggregate demand will change real GDP
D) the short-run aggregate supply curve is horizontal; the short-run aggregate supply curve is vertical
Answer: C
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

51) The factor leading to business cycles in the ________ cycle theory is unexpected fluctuations in aggregate demand while in the ________ cycle theory both unexpected and expected fluctuations in aggregate demand are factors that lead to business cycles.
A) new classical; monetarist
B) new classical; new Keynesian
C) new Keynesian; Keynesian
D) monetarist; new Keynesian
Answer: B
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

52) According to the new classical theory, ________ policy changes have no effect on real GDP and according to the new Keynesian theory, ________ policy changes have an effect on real GDP.
A) expected; expected
B) unexpected; expected
C) fiscal; monetary
D) fiscal; fiscal
Answer: A
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

53) According to the new classical theory, ________ policy changes have NO effect on real GDP and according to the new Keynesian theory, ________ policy changes have an effect on real GDP.
A) only expected; expected and unexpected
B) only unexpected; expected and unexpected
C) only expected; only unexpected
D) only unexpected; only expected
Answer: A
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

54) An unexpected decrease in aggregate demand will trigger a recession in the ________ theory of the business cycle.
A) new Keynesian cycle
B) new classical cycle
C) real business cycle
D) Both answers A and B are correct.
Answer: D
Topic: New Classical and New Keynesian Theories
Skill: Recognition
Status: Old
AACSB: Reflective thinking

55) The new Keynesian cycle theory of the business cycle regards ________ as the main source of economic fluctuations.
A) only unexpected fluctuations in aggregate demand
B) expected and unexpected fluctuations in aggregate demand
C) only expected fluctuations in aggregate demand
D) changes in business confidence
Answer: B
Topic: New Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

56) New Keynesian economists believe that ________ is influenced by ________.
A) yesterday's money wage rate; today's rational expectations of the money wage
B) today's money wage rate; yesterday's rational expectations of the price level
C) yesterday's rational expectations of the price level; today's money wage rate
D) today's money wage rate; today's rational expectations of the price level
Answer: B
Topic: New Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

57) Which business cycle theory emphasizes that, because of long-term wage agreements, both expected and unexpected fluctuations in aggregate demand can change real GDP?
A) the new classical cycle theory
B) the new Keynesian cycle theory
C) monetarist cycle theory
D) Keynesian cycle theory
Answer: B
Topic: New Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

58) The ________ theory of the business cycle asserts that expected and unexpected changes in aggregate demand lead to fluctuations in real GDP.
A) real business cycle
B) new classical cycle
C) new Keynesian cycle
D) None of the above answers are correct.
Answer: C
Topic: New Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

59) According to the new Keynesian cycle theory of the business cycle, which of the following can trigger a business cycle expansion?
I. an unexpected increase in the quantity of money
II. an expected increase in the quantity of money
III. an expected increase in government expenditure
A) I only
B) II and III
C) I, II and III
D) None of the three will trigger an expansion.
Answer: C
Topic: New Keynesian Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

60) In the new Keynesian business cycle theory, ________ can effect real GDP.
A) only expected changes in aggregate demand
B) expected and unexpected changes in aggregate demand
C) only unexpected changes in aggregate demand
D) only unexpected changes in the money wage rate
Answer: B
Topic: New Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

61) Suppose that the Federal Reserve is expected to expand the quantity of money by 5 percent but ends up expanding it by only 2 percent. If the new Keynesian theory is CORRECT, which of the following describes the effect on the economy?
A) The economy experience a boom because the quantity of money is still growing.
B) Inflation will be higher than expected.
C) Workers' decisions about when to work will be affected.
D) A recession will ensue.
Answer: D
Topic: New Keynesian Theory
Skill: Analytical
Status: Old
AACSB: Reflective thinking

62) Suppose the data show that an unexpected change in tax rates caused a recent recession. These data support which model of the business cycle?
A) new classical cycle theory
B) new Keynesian cycle theory
C) real business cycle theory
D) Both answers A and B are correct.
Answer: D
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

63) Which of the following are TRUE?
I. New Keynesian economists believe that money wage rates are influenced by rational expectations of the price level.
II. New classical economists believe that money wage rates are influenced by rational expectations of the price level.
III. New classical economists believe expected changes in aggregate demand trigger business cycles.
A) I and II
B) I and III
C) II and III
D) I, II and III
Answer: A
Topic: New Classical and New Keynesian Theories
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

64) Real business cycle theory says that the factor leading to the business cycle is represented by changes in
A) animal spirits.
B) the growth rate of the quantity of money.
C) only aggregate demand.
D) productivity.
Answer: D
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

65) The real business cycle theory asserts that changes in ________ lead to changes in ________.
A) the quantity of money; real GDP
B) technology; productivity
C) animal spirits; real GDP
D) consumption expenditure; real GDP
Answer: B
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

66) The factor leading to business cycles according to the real business cycle theory is changes in
A) the growth rate of the quantity of money.
B) technological change caused by changes in productivity.
C) productivity caused by changes in technology.
D) investment caused by changes in business confidence.
Answer: C
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

67) Real business cycle (RBC) theory predicts that the main source of economic fluctuations is represented by
A) sticky money wage rates.
B) rational expectations based on complete information.
C) changes in the growth rate of productivity.
D) None of the above answers is correct.
Answer: C
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

68) Real business cycle theory explains the business cycle as the result of
A) excess growth of the quantity of money.
B) unstable investment demand.
C) shocks to consumer spending habits.
D) fluctuations in productivity.
Answer: D
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

69) The factor that leads to business cycle events within real business cycle theory is represented by
A) changes in the growth rate in productivity.
B) changes in the growth rate in the quantity of money.
C) adverse shocks to international trade.
D) changes in expected future sales and profits of firms.
Answer: A
Topic: RBC Impulse
Skill: Recognition
Status: Revised
AACSB: Reflective thinking

70) In real business cycle theory, the factor leading to a business cycle is represented by
A) changes in investment.
B) changes in the quantity of money.
C) unexpected changes in aggregate demand.
D) fluctuations in the pace of technological change.
Answer: D
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

71) The factor leading to business cycles in the real business cycle theory is represented by changes in the growth rate of
A) the quantity of money.
B) productivity.
C) labor supply.
D) the money wage rate.
Answer: B
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

72) According to the real business cycle (RBC) theory, recessions are the result of
A) a fall in the growth rate of productivity.
B) an increase in the growth rate of the quantity of money.
C) an increase in investment.
D) a decrease in the growth rate of the quantity of money.
Answer: A
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

73) The theory that regards random fluctuations in productivity as the main source of economic fluctuations is the ________ of the business cycle.
A) real business cycle theory
B) productivity theory
C) dynamic general equilibrium theory
D) Keynesian cycle theory
Answer: A
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

74) Which theory views fluctuations in productivity as the main source of business cycle fluctuations?
A) real business cycle theory
B) Keynesian cycle theory
C) monetarist cycle theory
D) new classical cycle theory
Answer: A
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

75) When the recession started in 2008, the government estimated that labor productivity for the year was -2.8 percent. This result is most in line with which theory of business cycle fluctuations?
A) real business cycle theory
B) Keynesian cycle theory
C) monetarist cycle theory
D) new classical cycle theory
Answer: A
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

76) According to the real business cycle theory, technological change
A) occurs at a constant rate.
B) happens only occasionally.
C) happens at an uneven pace.
D) has been rising in recent years at an increasing rate.
Answer: C
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

77) According to the real business cycle theory, technological change
A) always increases productivity.
B) never increases productivity.
C) can initially decrease productivity.
D) is caused by changes in productivity.
Answer: C
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

78) The real business cycle (RBC) theory argues that the impact of technological change on real GDP is
A) always positive.
B) usually positive but occasionally negative.
C) always negative.
D) nonexistent.
Answer: B
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

79) According to the ________ theory, technological change can be so rapid that some existing capital becomes obsolete and ________.
A) real business cycle; aggregate demand increases
B) new classical; productivity falls
C) new classical; aggregate demand increases
D) real business cycle; productivity falls
Answer: D
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

80) Evidence indicates that a recession occurs at about the same time as a decrease in investment. According to the real business cycle theory, the decrease in investment is attributable to
A) a fall in animal spirits.
B) a decrease in productivity.
C) a decrease in the growth rate of the quantity of money.
D) intertemporal substitution in working decisions.
Answer: B
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

81) Which of the following pieces of evidence is most consistent with the real business cycle theory?
A) Labor supply decisions do not seem to depend on real interest rates.
B) Real GDP and the quantity of money move closely together.
C) Money wage rates take some time to adjust to price changes.
D) Productivity and GDP move closely together.
Answer: D
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

82) Looking at U.S. economic history between 1964 and 2009, we see that growth in real GDP
A) was not correlated with fluctuations in productivity growth.
B) falls following an increase in productivity growth.
C) rises following an increase in productivity growth.
D) rises following a decrease in productivity growth.
Answer: C
Topic: RBC Impulse
Skill: Recognition
Status: Old
AACSB: Reflective thinking

83) The key ripple effect in real business cycle theory is the ________ decision and it depends on the ________.
A) when-to-invest; real interest rate
B) when-to-work; real interest rate
C) what-to-save; nominal interest rate
D) where-to-work; real wage rate
Answer: B
Topic: Real Business Cycle Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

84) According to the real business cycle theory, the immediate effects from a change in productivity include
which of the following?
I. Investment demand changes.
II. Demand for labor changes.
III. Government expenditures change.
A) I
B) I and II
C) I and III
D) II and III
Answer: B
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

85) "Intertemporal substitution" in labor supply describes changes in labor supply in response to changes in
A) personal tax rates.
B) investment spending.
C) the real interest rate.
D) consumer demand for goods.
Answer: C
Topic: RBC Mechanism
Skill: Recognition
Status: Old
AACSB: Reflective thinking

86) Which theory maintains that the money wage rate always adjusts freely?
A) Keynesian cycle theory
B) monetarist cycle theory
C) both the new classical cycle theory and the new Keynesian cycle theory
D) real business cycle theory
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

87) In real business cycle theory, a decrease in productivity leads to all of the following events EXCEPT
A) a decrease in the demand for labor.
B) a decrease in investment demand.
C) a rise in the real wage rate.
D) a fall in the real interest rate.
Answer: C
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

88) In a real business cycle model, labor supply
A) increases if the nominal interest rate rises.
B) is independent of the real interest rate.
C) decreases if the real interest rate rises.
D) decreases if the real interest rate falls.
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

89) In the real business cycle framework, a technology shock that increases investment demand and the demand for loanable funds leads to a ________ quantity of saving and a ________ real interest rate.
A) higher; higher
B) higher; lower
C) lower; higher
D) lower; lower
Answer: A
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

90) Suppose that a severe shock that decreases the demand for loanable funds hits the United States. Which of the following can we expect to occur according to the real business cycle model?
A) The real interest rate will fall.
B) People will work fewer hours.
C) The real wage rate will fall.
D) All of the above are true.
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

91) According to the real business cycle theory, a technology shock that decreases the demand for loanable funds will ________ employment and will ________ real GDP.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

92) According to real business cycle theory proponents, an increase in productivity ________ the demand for loanable funds, ________ the demand for labor, and ________ the supply of labor. The real interest rate will ________.
A) increases; increases; there is no change in; fall
B) increases; increases; there is no change in; rise
C) decreases; decreases; decreases; fall
D) increases; increases; increases; rise
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

93) According to the real business cycle (RBC) theory, during a recession the demand for labor ________ and the supply of labor ________.
A) increases; decreases
B) decreases; does not change
C) does not change; decreases
D) decreases; decreases
Answer: D
Topic: Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

94) According to the real business cycle theory, a fall in the real interest rate ________ current labor supply and ________ current employment.
A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

95) Real business cycle economists claim that the intertemporal substitution effect
A) plays a small role in the labor market.
B) depends on the real interest rate.
C) plays a large role in the economy only during expansions.
D) has unpredictable effects on the economy.
Answer: B
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

96) According to the real business cycle theory, workers' decisions to work now versus later depend on
A) the real wage rate today but not the real wage rate in the future.
B) the money wage rate.
C) the real interest rate.
D) labor productivity.
Answer: C
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

97) Suppose that in response to a decrease in real interest rates, a person decides to reduce his labor supply today and increase it in the future. This behavior is most consistent with the
A) new classical theory of the business cycle.
B) Keynesian theory of the business cycle.
C) new Keynesian theory of the business cycle.
D) real business cycle theory.
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

98) If the real interest rate is 4 percent and workers expect real wages to be 2 percent higher next year, according to the real business cycle theory, workers will work
A) more this year and less next year.
B) less this year and less next year.
C) more this year and more next year.
D) less this year and more next year.
Answer: A
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

99) If the real interest rate is 2 percent and workers expect real wages to be 4 percent higher next year, according to the real business cycle theory, workers will work

A) more this year and less next year.
B) less this year and less next year.
C) more this year and more next year.
D) less this year and more next year.
Answer: D
Topic: RBC Mechanism
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

100) In the real business cycle model, the quantity of money

A) can change the real wage rate.
B) can increase the real interest rate.
C) has no effect on real GDP.
D) can decrease the effect from technology shocks.
Answer: C
Topic: Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

101) According to real business cycle (RBC) theory, a change in the quantity of money leads to

A) a change in the price level and in real GDP.
B) a change in the price level but no change in real GDP.
C) a change in investment and real GDP.
D) a change in the real wage rate and the money wage rate.
Answer: B
Topic: Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

102) According to which theory of the business cycle do changes in the quantity of money NEVER play a role in helping to explain fluctuations in real variables?

A) Keynesian
B) monetarist
C) new Keynesian
D) real business cycle
Answer: D
Topic: Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

103) In real business cycle models, in order to increase real GDP after a negative technology shock, the government can
I. increase the quantity of money.
II. decrease the quantity of money.
A) only I
B) only II
C) both I and II
D) neither I nor II
Answer: D
Topic: Real Business Cycle Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

104) Critics of the real business cycle model argue that
A) investment spending is strongly related to the real interest rate.
B) labor supply is only weakly related to the real interest rate.
C) investment spending is only weakly related to the real interest rate.
D) labor supply is very strongly related to the real interest rate.
Answer: B
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

105) Which of the following is <u>NOT</u> one of the criticisms of real business cycle theory?
A) The money wage rate is sticky in the short run.
B) Inter-temporal substitution is too weak.
C) Productivity fluctuations are the result of the business cycle, not the cause of business cycles.
D) The theory is built on weak microeconomic foundations.
Answer: D
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

106) Critics of the real business cycle theory claim that
A) both real and nominal variables change during the business cycle.
B) the intertemporal substitution effect is too weak to account for changes in labor supply.
C) changes in technology cannot cause economic growth.
D) Both answers B and C are correct.
Answer: B
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

107) Suppose an economist finds that real interest rates are extremely high in most recession, which are the times when employment is low. This finding would pose the biggest problem for the
A) new classical theory of the business cycle.
B) real business cycle theory.
C) new Keynesian theory of the business cycle.
D) Keynesian theory of the business cycle.
Answer: B
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

108) A criticism of the real business cycle (RBC) theory is that
A) the money wage rate is flexible.
B) potential GDP does not vary with changes in the quantity of money.
C) productivity fluctuations might be caused by the business cycle.
D) All of the above answers are correct.
Answer: C
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

109) Which of the following is a criticism of the real business cycle theory?
A) Real business cycle theory fails to explain the phenomenon of economic growth.
B) Real business cycle theory assumes that money wage rates are sticky.
C) Real business cycle theory believes that productivity changes are caused by technology changes when in fact they are caused by changes in aggregate demand.
D) None of the above are criticisms of real business cycle theory.
Answer: C
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

110) Which of the following theories is criticized for assuming the money wage rate is not sticky?
A) monetarist cycle theory
B) real business cycle theory
C) Keynesian cycle theory
D) new Keynesian cycle theory
Answer: B
Topic: Criticisms of Real Business Cycle Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

111) Which of the following is the factor that creates business cycles in the real business cycle theory?
A) an unexpected change in aggregate demand
B) a change by the Fed in the growth rate of the quantity of money
C) a change in expectations about future sales and profits
D) a change in the growth rate of productivity
Answer: D
Topic: Study Guide Question, Real Business Cycle Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

112) By itself, an increase in aggregate demand increases GDP by the least amount in the
A) Keynesian theory.
B) monetarist theory.
C) new Keynesian theory.
D) real business cycle theory.
Answer: D
Topic: Study Guide Question, Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

113) Which of the following is the factor that leads to business cycles in the Keynesian business cycle theory?
A) an unexpected change in aggregate demand
B) a change by the Fed in the growth rate of the quantity of money
C) a change in business confidence
D) a change in the growth rate of productivity
Answer: C
Topic: Study Guide Question, Keynesian Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

114) Which of the following is the factor that leads to business cycles in the monetarist business cycle theory?
A) an unexpected change in aggregate demand
B) a change by the Fed in the growth rate of the quantity of money
C) a change in business confidence
D) a change in the growth rate of productivity
Answer: B
Topic: Study Guide Question, Monetarist Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

115) Which of the following is the factor that leads to business cycles in the new classical business cycle theory?
A) an unexpected change in aggregate demand
B) a change by the Fed in the growth rate of the quantity of money
C) a change in business confidence
D) a change in the growth rate of productivity
Answer: A
Topic: Study Guide Question, New Classical Theory
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2 Inflation Cycles

1) Which of the following can start an inflation?
A) an increase in aggregate demand
B) an increase in aggregate supply
C) a decrease in aggregate supply
D) Both answers A and C are correct.
Answer: D
Topic: Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

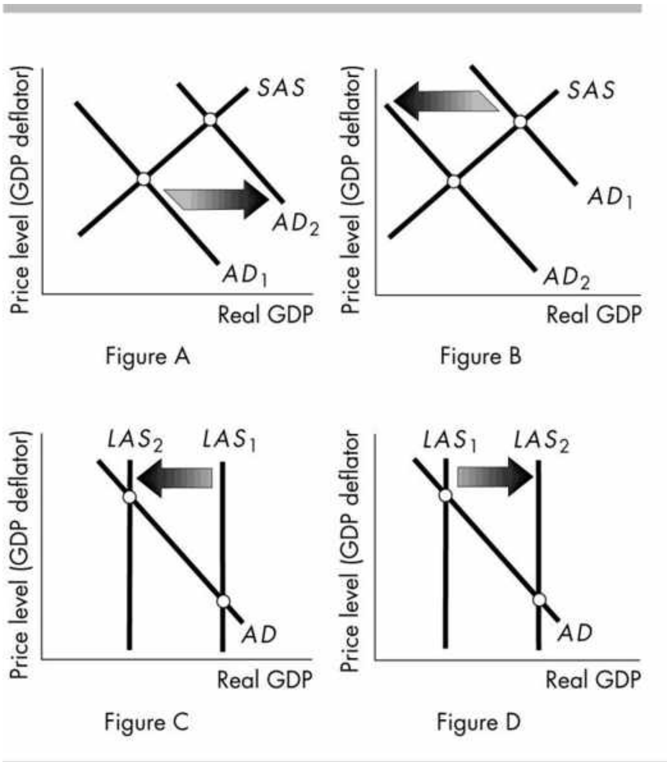
2) Inflation can be started by
A) a decrease in aggregate supply or a decrease in aggregate demand.
B) a decrease in aggregate supply or an increase in aggregate demand.
C) an increase in aggregate supply or an increase in aggregate demand.
D) an increase in aggregate supply or a decrease in aggregate demand.
Answer: B
Topic: Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

3) Demand-pull inflation starts with
A) an increase in aggregate demand.
B) a decrease in aggregate demand.
C) an increase in short-run aggregate supply.
D) a decrease in short-run aggregate supply.
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

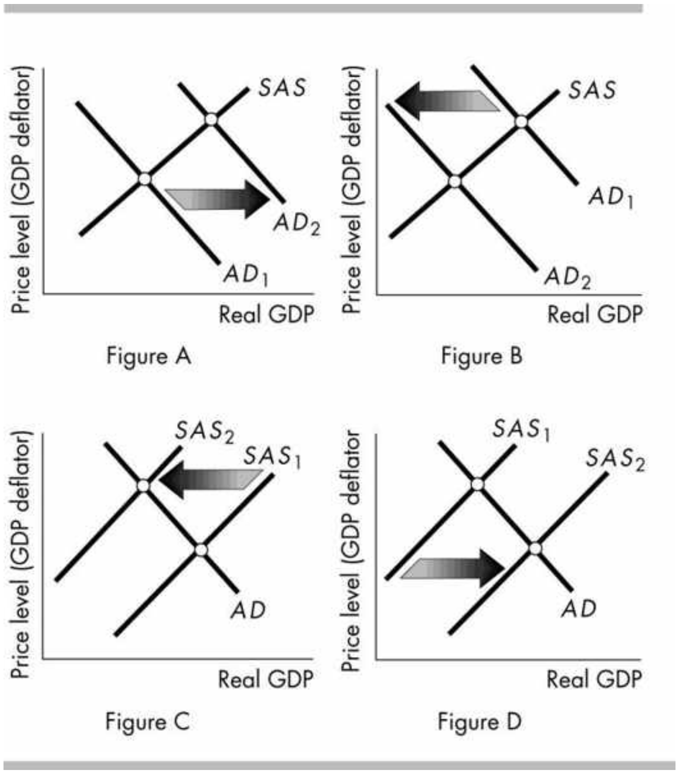
4) Demand-pull inflation is an inflation that results from an initial
A) increase in aggregate demand.
B) decrease in aggregate demand.
C) increase in wage rates.
D) increase in natural resource prices.
Answer: A
Topic: Demand-Pull Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

5) Demand-pull inflation starts with a shift of the
A) *SAS* curve rightward.
B) *AD* curve rightward.
C) *SAS* curve leftward.
D) *AD* curve leftward.
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

6) Demand-pull inflation starts as the
A) *LAS* curve shifts leftward.
B) *LAS* curve shifts rightward.
C) *AD* curve shifts rightward.
D) *AD* curve shifts leftward.
Answer: C
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking



7) Which of the above figures best shows the start of a demand-pull inflation?
A) Figure A
B) Figure B
C) Figure C
D) Figure D
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Analytical
Status: Old
AACSB: Analytical thinking



8) Which of the above figures best shows the start of a demand-pull inflation?
A) Figure A
B) Figure B
C) Figure C
D) Figure D
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Analytical
Status: Old
AACSB: Analytical thinking

9) Which of the above figures show how inflation can start in an economy?
A) Figure A and Figure C
B) Figure A and Figure D
C) Figure B and Figure C
D) Figure B and Figure D
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Analytical
Status: Old
AACSB: Analytical thinking

10) Demand-pull inflation can start when
A) the money wage rate rises but the price level does not change.
B) the money wage rate rises faster than the price level.
C) the short-run aggregate supply curve shifts rightward.
D) the aggregate demand curve shifts rightward.
Answer: D
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

11) Demand pull inflation can be started by
A) a decrease in the quantity of money.
B) an increase in government expenditure.
C) a decrease in net exports.
D) an increase in the price of oil
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

12) Which of the following factors could start a demand-pull inflation?
A) an increase in tax rates
B) a decrease in government expenditure
C) a decrease in wage rates
D) an increase in exports
Answer: D
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

13) Which of the following could lead to demand-pull inflation?
A) an increase in the money wage rate
B) an increase in the quantity of money
C) a decrease in exports
D) an increase in oil prices
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

14) Which of the following could start a demand-pull inflation?
A) an increase in government expenditure
B) an increase in imports
C) a decrease in the quantity of money
D) an increase in the money prices of raw materials
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

15) Increases in the quantity of money can start a ________ inflation and an increase in government expenditure can start a ________ inflation.
A) demand-pull; demand-pull
B) demand-pull; cost-push
C) cost-push; cost-push
D) cost-push; demand-pull
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

16) Which of the following can start a demand-pull inflation?
A) an improvement in technology
B) a decrease in productivity
C) an increase in imports
D) None of the above can start a demand-pull inflation.
Answer: D
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

17) Demand-pull inflation could start with
A) an increase in government expenditure followed by an increase in the money wage rate.
B) an increase in the quantity of money followed by a decrease in the money wage rate.
C) a rise in prices of raw materials followed by an increase in the quantity of money.
D) a decrease in exports followed by a decrease in the quantity of money.
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

18) Which of the following is <u>NOT</u> a potential start of a demand-pull inflation?
A) an increase in the money wage rate
B) an increase in the quantity of money
C) an increase in government expenditure
D) an increase in exports
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

19) Which of the following is <u>NOT</u> a potential start of a demand-pull inflation?
A) an increase in the quantity of money
B) an increase in government expenditure
C) an increase in taxes
D) an increase in exports
Answer: C
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Recognition
Status: Old
AACSB: Reflective thinking

20) Which of the following is a change that would <u>NOT</u> start a demand-pull inflation?
A) an increase in exports
B) an increase in labor productivity
C) an increase in government expenditure on goods and services
D) an increase in the quantity of money
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

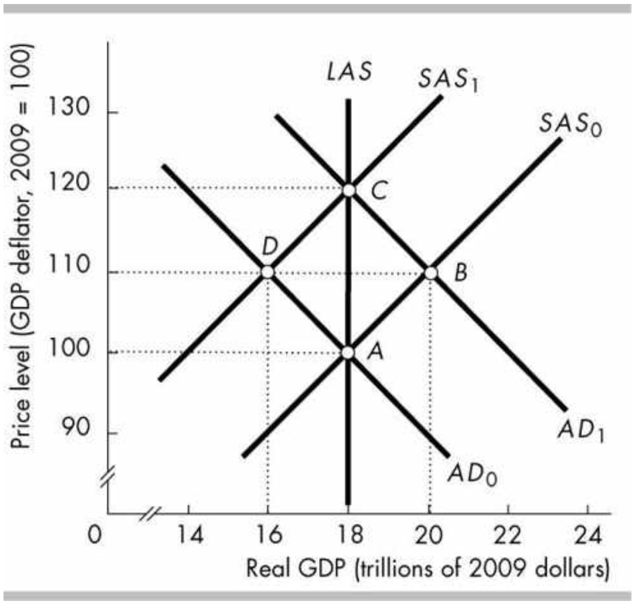
21) Which of the following could <u>NOT</u> start a demand-pull inflation?
A) increases in government expenditure
B) increases in net exports
C) increases in oil prices
D) increases in the quantity of money
Answer: C
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

22) Initially, demand-pull inflation will
A) increase the price level and not change real GDP.
B) increase the price level and increase real GDP.
C) increase the price level and decrease real GDP.
D) shift the aggregate supply curve rightward.
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

23) If demand pull inflation occurs when the economy is already at potential GDP, then following the initial increase in aggregate demand, the
A) *SAS* curve shifts rightward.
B) *LAS* curve shifts rightward.
C) *SAS* curve shifts leftward.
D) *LAS* curve shifts leftward.
Answer: C
Topic: Wage Response
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

24) A demand-pull inflation is initially characterized by
A) increasing real output and a labor shortage.
B) increasing real output and a labor surplus.
C) decreasing real output and a labor shortage.
D) decreasing real output and a labor surplus.
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

25) If an economy at potential GDP experiences a demand shock that shifts the aggregate demand curve rightward, there will be
A) an eventual leftward shift in the short-run aggregate supply curve.
B) unemployment below the natural rate.
C) upward pressure on money wage rates.
D) All of the above answers are correct.
Answer: D
Topic: Wage Response
Skill: Conceptual
Status: Old
AACSB: Reflective thinking



26) In the above figure, suppose that the economy is at point *A* when the quantity of money increases. In the short run, the economy will move to point
A) *A*, that is, the price level and level of real GDP will not change.
B) *B*.
C) *C*.
D) *D*.
Answer: B
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

27) In the above figure, suppose that the economy is at point *A* when foreign countries begin an expansion and buy more U.S.-made goods. In the short run, this change creates a movement to point ________ and afterwards an eventual increase in ________.
A) *B*; money wage rates
B) *D*; the natural unemployment rate
C) *B*; the natural unemployment rate
D) *D*; money wage rates
Answer: A
Topic: Wage Response
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

28) An initial increase in aggregate demand that is NOT followed by an increase in the quantity of money results in a long-run equilibrium with
A) a higher price level but the same real GDP.
B) a higher price level and a higher level of real GDP.
C) the same price level and a lower level of real GDP.
D) None of the above answers are correct.
Answer: A
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Analytical
Status: Revised
AACSB: Reflective thinking

29) Suppose that a shock causes the aggregate demand curve to shift rightward. If the Fed does nothing
A) the economy will experience a temporary reduction in employment but will eventually return to full employment.
B) output initially will exceed potential GDP, but the economy will return to potential GDP with a higher price level.
C) the short-run aggregate supply curve will not shift leftward and there will be continued inflation.
D) eventually the short-run aggregate supply curve will shift leftward and there will be continued inflation.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

30) For an economy at full employment, an increase in the quantity of money will lead to which of the following sequences of shifts in aggregate demand and supply curves?
A) decreased aggregate demand, increased short-run aggregate supply, constant long-run aggregate supply
B) decreased aggregate demand, decreased short-run aggregate supply, decreased long-run aggregate supply
C) increased aggregate demand, increased short-run aggregate supply, increased long-run aggregate supply
D) increased aggregate demand, decreased short-run aggregate supply, constant long-run aggregate supply
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

31) A one-time rise in the price level can turn into a demand-pull inflation when
A) the money wage rate continues to increase.
B) the quantity of money persistently decreases.
C) taxes consistently increase.
D) the quantity of money persistently increases.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

32) A demand-pull inflation process consists of ________ shifts in the *AD* curve and ________ shifts in the *SAS* curve.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

33) In a persisting demand-pull inflation
A) short-run aggregate supply decreases and aggregate demand increases.
B) aggregate demand and short-run aggregate supply both decrease.
C) aggregate demand increases and long-run aggregate supply decreases.
D) None of the above answers are correct.
Answer: A
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

34) Demand-pull inflation results from continually increasing the quantity of money, which leads to a continually
A) decreasing long-run aggregate supply.
B) increasing aggregate supply.
C) decreasing aggregate demand.
D) increasing aggregate demand.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

35) Demand-pull inflation persists because of
A) continuing increases in government expenditures.
B) continuing increases in the quantity of money.
C) continuing increases in real wage rates.
D) continuing increases in aggregate supply.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

36) A demand-pull inflation requires persistent increases in
A) tax rates.
B) real wages.
C) the quantity of money.
D) government expenditures.
Answer: C
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

37) If the Fed responds to an initial increase in aggregate demand by increasing the quantity of money
A) there will be no inflationary gap.
B) real GDP will begin to decrease more rapidly than if the quantity of money had remained constant.
C) money wages will fall to reduce unemployment.
D) there is the risk of continued inflation.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

38) In a demand-pull inflation brought about by increases in the quantity of money, real GDP might increase temporarily because
A) tax rates decline.
B) real wages fall.
C) money wages fall.
D) real wages rise.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

39) If the Fed responds to an increase in aggregate demand by increasing the quantity of money
A) nothing happens because aggregate demand had already increased.
B) output will begin to decrease more rapidly than in the case in which only the first increase in aggregate demand happened.
C) money wage rates will fall to reduce unemployment.
D) there will be continued inflation.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

40) If the economy is at potential GDP and the Fed increases the quantity of money, then
A) potential GDP rises.
B) real GDP rises temporarily above potential GDP.
C) real GDP rises permanently above potential GDP.
D) potential GDP and real GDP both decrease.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

41) During a demand-pull inflation, if the Fed tries to maintain a level of real GDP above potential GDP
A) there will be a one-time shift in the *AD* and the *SAS* curves.
B) the *AD* curve will shift rightward continuously and *SAS* curves will shift leftward continuously.
C) the *AD* curve will shift rightward continuously and the *SAS* curve will not shift.
D) the *SAS* curve will shift leftward continuously and the *AD* curve will not shift.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

42) In a demand-pull inflation, money wage rates rise because
A) a decrease in aggregate demand creates a labor shortage.
B) an increase in aggregate demand creates a labor surplus.
C) an increase in aggregate demand creates a labor shortage.
D) a decrease in aggregate demand creates a labor surplus.
Answer: C
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

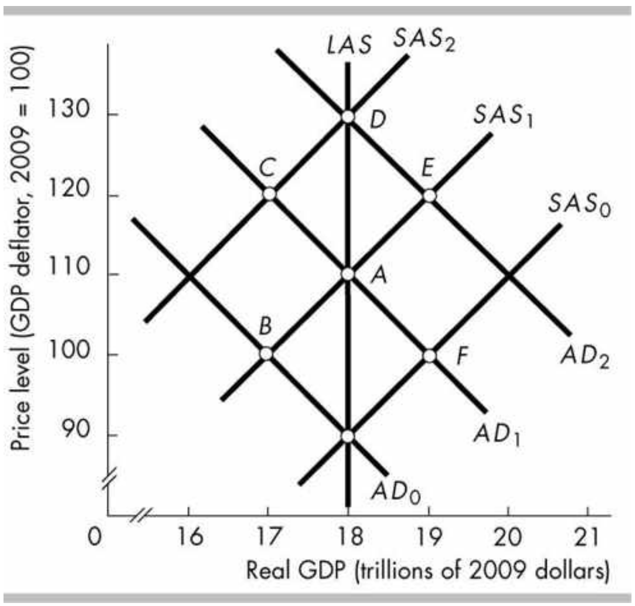
43) As the money wage rate rises
A) the long-run aggregate supply curve shifts rightward.
B) the short-run aggregate supply curve shifts rightward.
C) both the long-run aggregate supply curve and the short-run aggregate supply curve shift leftward.
D) the short-run aggregate supply curve shifts leftward.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

44) When the *AD* and *SAS* curves intersect at a level of real GDP which exceeds potential GDP and there is no government policy undertaken, which of the following will occur?
A) The *AD* curve shifts rightward because the Fed decreases the money supply.
B) The *SAS* curve shifts leftward because the money wage rate rises.
C) The *SAS* curve shifts leftward because the money wage rate falls.
D) The *AD* curve shifts leftward because the money wage rate rises.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

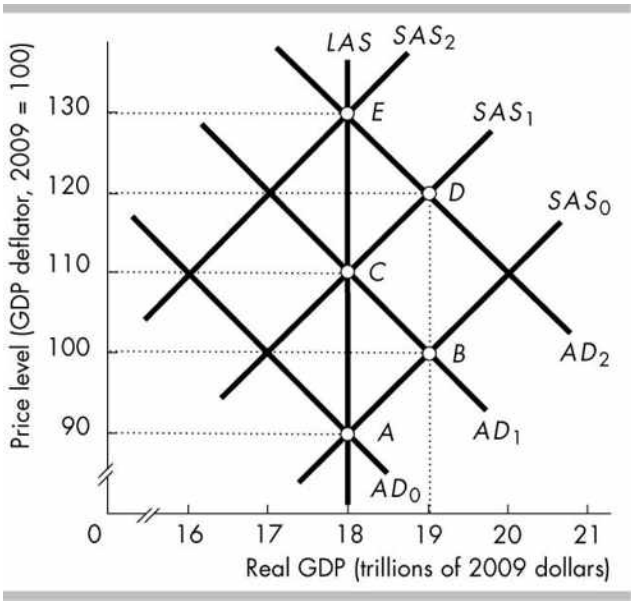
45) To prevent demand-pull inflation
A) firms must refuse to increase wages.
B) the Fed must not let the quantity of money persistently rise.
C) the natural unemployment rate must increase.
D) real GDP must increase.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

46) To stop a demand-pull inflation using monetary policy, you would recommend that the Fed
A) increase the quantity of money.
B) not increase the quantity of money.
C) increase tax rates.
D) purchase government bonds in the open market.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Analytical
Status: Old
AACSB: Reflective thinking

47) In a demand-pull inflation, if the Fed stops expanding the quantity of money
A) a cost-push inflation spiral will occur.
B) government expenditure will cause the demand-pull inflation to continue.
C) a deflation will occur.
D) the demand-pull inflation spiral ends.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

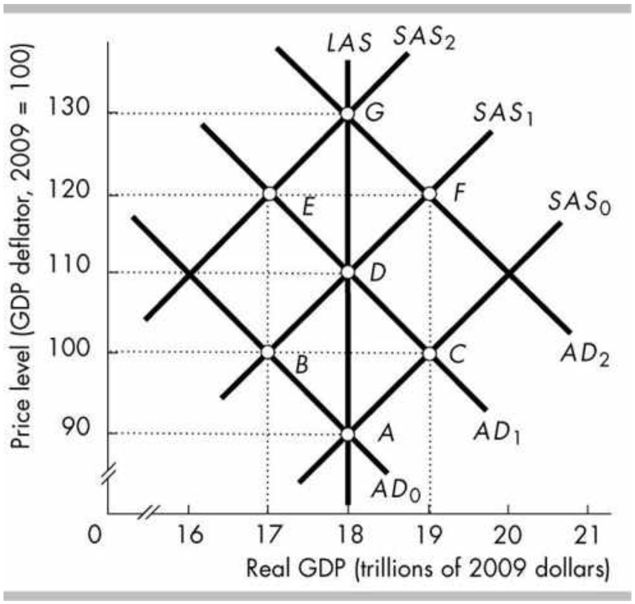


48) The figure above shows the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for the U.S. economy. The economy is currently at point *A*. A demand-pull rise in the price level will initially move the economy to point ________ and to point ________.
A) *E* when aggregate demand increases; *D* when the wage rate rises
B) *B* when aggregate demand decreases; *C* when the wage rate rises
C) *E* when aggregate demand increases; *A* when the wage rate rises
D) *C* when the wage rate rises; *D* when aggregate demand increases
Answer: A
Topic: A Demand-Pull Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

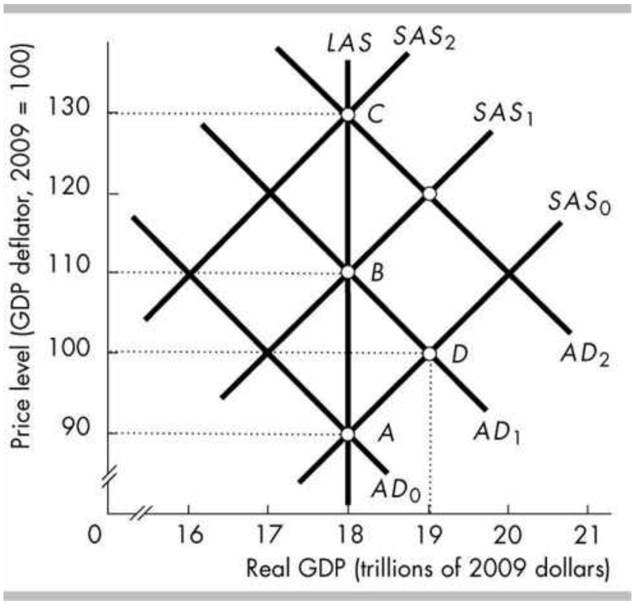


49) In the above figure, the movement from point *A* to *B* to *C* to *D* to *E* represents
A) demand-pull inflation resulting solely from wage responses to excess labor demand.
B) demand-pull inflation resulting from persistent increases in the quantity of money.
C) cost-push inflation resulting solely from wage responses to excess labor demand.
D) cost-push inflation resulting from persistent increases in the quantity of money.
Answer: B
Topic: A Demand-Pull Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

50) In the above figure, if the economy moves from point *A* to point *E*
A) money wage rates have increased.
B) there may have been demand-pull inflation.
C) there has been economic growth.
D) Both answers A and B are correct.
Answer: D
Topic: A Demand-Pull Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking



51) In the above figure, which path represents a demand-pull inflation?
A) point *A* to *C* to *D* to *F* to *G*
B) point *A* to *B* to *D* to *E* to *G*
C) point *A* to *C* to *D* to *E* to *G*
D) point *A* to *B* to *D* to *F* to *G*
Answer: A
Topic: A Demand-Pull Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking



52) In the above figure, the economy initially is at point *A* and then an increase in the quantity of money moves the economy to point *D*. At point *D*, the real wage rate has
A) risen by the same percentage as the price level.
B) remained constant.
C) risen.
D) fallen.
Answer: D
Topic: Initial Effect of an Increase in Aggregate Demand
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

53) In the above figure, the economy initially is at point *A* and then an increase in the quantity of money moves the economy to point *D*. The money wage rate will then start to
A) rise because a labor shortage now exists.
B) fall because a labor shortage now exists.
C) rise because a labor surplus now exists.
D) fall because a labor surplus now exists.
Answer: A
Topic: Wage Response
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

54) In the above figure, the economy initially is at point A and then an increase in the quantity of money moves the economy to point D. If the quantity of money remains constant, the economy will adjust with the

A) short-run aggregate supply shifting leftward to SAS_1.

B) short-run aggregate supply shifting leftward to SAS_2.

C) aggregate demand shifting back to AD_0.

D) aggregate demand shifting to AD_2.

Answer: A

Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

55) A demand-pull inflation occurred in the United States during most of the later part of the

A) 1960s.
B) 2000s.
C) 1980s.
D) 1990s.

Answer: A

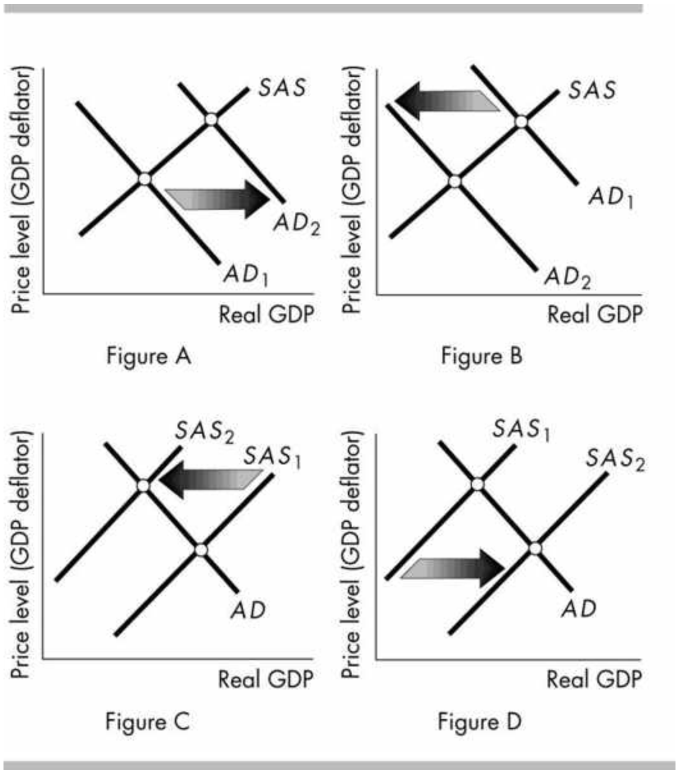
Topic: Demand-Pull Inflation in the United States
Skill: Recognition
Status: Old
AACSB: Reflective thinking

56) As far as demand-pull inflation goes, the United States

A) has never experienced this type of inflation.
B) experienced this type of inflation during the 1990s.
C) experienced this type of inflation during the 1960s.
D) experienced this type of inflation during the 1950s.

Answer: C

Topic: Demand-Pull Inflation in the United States
Skill: Recognition
Status: Old
AACSB: Reflective thinking



57) In the above, which figure shows the start of a cost-push inflation?
A) Figure A
B) Figure B
C) Figure C
D) Figure D
Answer: C
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Analytical
Status: Old
AACSB: Analytical thinking

58) The main sources of cost-push inflation are increases in
A) money wage rates and the cost of raw materials.
B) real wage rates and the cost of raw materials.
C) money wage rates and aggregate demand.
D) aggregate demand and real wage rates.
Answer: A
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

59) Assuming that GDP currently equals potential GDP, a cost-push inflation could result from which of the following?
A) a decrease in tax rates
B) an increase in the labor force
C) a large crop failure that boosts the prices of raw food materials
D) an increase in the nation's capital stock
Answer: C
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

60) Cost-push inflation can be started by
A) a decrease in the money wage rate.
B) an increase in the money prices of raw materials.
C) an increase in the quantity of money.
D) a decrease in government expenditure on goods and services.
Answer: B
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

61) Cost-push inflation can start with
A) lower taxes.
B) an increase in government expenditure.
C) higher money wage rates.
D) an increase in transfer payments.
Answer: C
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

62) Cost-push inflation can start with
A) a decrease in investment.
B) an increase in oil prices.
C) an increase in government expenditure.
D) a decrease in the quantity of money.
Answer: B
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

63) Cost-push inflation might initially result from
A) an increase in the quantity of money.
B) the use of new technology.
C) an increase in government expenditure.
D) an increase in the cost of resources.
Answer: D
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

64) In April 2008 the price of oil was approximately $130 per barrel; in April 2017, it was approximately $50 per barrel. This change in the price of oil could have started
A) a cost-push inflation.
B) a demand-pull inflation.
C) both a cost-push and a demand-pull inflation.
D) None of the above answers are correct.
Answer: D
Topic: Cost-Push Inflation
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

65) Cost-push inflation is an inflation that results from an initial
A) increase in money wage rates or money prices of raw materials.
B) decrease in taxes.
C) increase in investment.
D) increase in taxes.
Answer: A
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

66) The <u>INITIAL</u> factors that can create a cost-push inflation do <u>NOT</u> include
A) increases in money wage rates.
B) increases in the money prices of raw materials.
C) increases in the quantity of money.
D) None of the above answers is correct because all of the above could be the initial cause of a cost-push inflation.
Answer: C
Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

67) At the start of a cost-push inflation
A) productivity rises.
B) real GDP increases faster than the quantity of money.
C) the short-run aggregate supply curve shifts rightward.
D) prices and unemployment are rising.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

68) The start of a cost-push inflation results in
A) falling GDP and falling unemployment rate.
B) raising GDP and rising unemployment rate.
C) falling GDP and rising unemployment rate.
D) raising GDP and falling unemployment rate.
Answer: C
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

69) Cost-push inflation starts with
A) an increase in aggregate demand.
B) a decrease in aggregate demand.
C) an increase in short-run aggregate supply.
D) a decrease in short-run aggregate supply.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Recognition
Status: Old
AACSB: Reflective thinking

70) A leftward shift in the short run aggregate supply curve
A) is the result of the Fed increasing the quantity of money.
B) is the result of a rise in the price of a key resource.
C) is the result of consumer expenditures exceeding available output.
D) increases both the price level and real GDP.
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Recognition
Status: Old
AACSB: Reflective thinking

71) When a cost-push inflation starts
A) the price level falls and the money wages rises.
B) real GDP rises faster than the quantity of money.
C) the short-run aggregate supply curve shifts rightward.
D) the price level rises and real GDP decreases.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Recognition
Status: Old
AACSB: Reflective thinking

72) At the start of a cost-push inflation
A) only real GDP changes while the price level remains constant.
B) the price level and real GDP both increase.
C) the price level rises and real GDP decreases.
D) the price level rises and real GDP does not change.
Answer: C
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

73) Suppose that the money prices of raw materials increase so that the short-run aggregate supply decreases. If the Federal Reserve does not respond, the higher money price of raw materials will
I. repeatedly shift the aggregate demand curve rightward and raise the price level.
II. shift the aggregate demand curve rightward and the aggregate supply curve leftward, raising prices.
III. result initially in lower employment and a higher price level.
A) I only
B) both I and II
C) both II and III
D) III only
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

74) An increase in the money wage rate shifts the *SAS* curve ________ and an increase in the money prices of raw materials shifts the *SAS* curve ________.
A) rightward; rightward
B) leftward; leftward
C) rightward; leftward
D) leftward; rightward
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Recognition
Status: Old
AACSB: Analytical thinking

75) A higher price for oil shifts the
A) *SAS* curve leftward.
B) *LAS* curve leftward.
C) *SAS* curve rightward.
D) *AD* curve rightward.
Answer: A
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Recognition
Status: Old
AACSB: Analytical thinking

76) By itself, an increase in the price of oil shifts the
A) short-run aggregate supply curve leftward and does not shift the aggregate demand curve.
B) short-run aggregate supply curve rightward and does not shift the aggregate demand curve.
C) aggregate demand curve leftward and does not shift the short-run aggregate supply curve.
D) aggregate demand curve rightward and does not shift the short-run aggregate supply curve.
Answer: A
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

77) By itself, a fall in the price of oil shifts the
A) short-run aggregate supply curve leftward and does not shift the aggregate demand curve.
B) short-run aggregate supply curve rightward and does not shift the aggregate demand curve.
C) aggregate demand curve leftward and does not shift the short-run aggregate supply curve.
D) aggregate demand curve rightward and does not shift the short-run aggregate supply curve.
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

78) The *SAS* curve shifts leftward if
A) good weather increases agricultural harvests.
B) OPEC reduces world oil prices.
C) tax cuts stimulate labor supply.
D) the money wage rate increases.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

79) If the prices of crucial raw materials increase
A) the short-run aggregate supply curve shifts leftward.
B) stagflation could occur.
C) a cost-push inflation could occur depending on the behavior of the Federal Reserve.
D) All of the above answers are correct.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

80) An increase in the price of a resource such as oil
I. shifts the aggregate demand curve leftward.
II. shifts the long-run aggregate supply curve rightward.
III. shifts the short-run aggregate supply curve leftward.
IV. increases the price level and decreases real GDP in the short run.
A) Only I is correct.
B) Both I and II are correct.
C) Only III is correct.
D) Both III and IV are correct.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

81) If oil prices increase, then in the short run, real GDP will ________ and the price level will ________.
A) increase; rise
B) increase; fall
C) decrease; rise
D) decrease; fall
Answer: C
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

82) In the short-run, an increase in the price of raw materials will ________ the price level and ________ real GDP.
A) raise; increase
B) raise; decrease
C) lower; increase
D) lower; decrease
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

83) In the short run, if there is an increase in the money wage rate, then
A) short-run aggregate supply increases and the price level rises.
B) short-run aggregate supply decreases and the price level rises.
C) aggregate demand decreases and the price level falls.
D) aggregate demand increases and the price level rises.
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

84) By ITSELF, a supply shock such as an increase in the price of oil, will
A) cause real GDP to permanently decrease year after year.
B) not cause inflation if there is no policy response.
C) be inflationary as long as there is no policy response.
D) cause a wage-price spiral.
Answer: B
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

85) Stagflation occurs when the price level ________ and real GDP ________.
A) falls; increases
B) falls; decreases
C) rises; decreases
D) rises; increases
Answer: C
Topic: Stagflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

86) Stagflation is the result of
A) an increase in aggregate demand.
B) a decrease in short-run aggregate supply.
C) a decrease in aggregate demand.
D) an increase in short-run aggregate supply.
Answer: B
Topic: Stagflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

87) Stagflation is the combination of a ________ and ________.
A) falling inflation rate; an increasing real GDP
B) falling price level; an increasing real GDP
C) rising price level; a decreasing real GDP
D) rising inflation rate; a decreasing real GDP
Answer: C
Topic: Stagflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

88) Stagflation occurs when the
A) price level and real GDP are increasing at the same time.
B) price level and real GDP are decreasing at the same time.
C) price level is increasing and real GDP is decreasing.
D) price level is decreasing and real GDP is increasing.
Answer: C
Topic: Stagflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

89) The term "stagflation" refers to the situation when
A) the aggregate supply curve shifts leftward, prices increase and real GDP decreases.
B) real GDP and the price level both rise because of an increase in aggregate demand.
C) prices become stagnant and do not increase or decrease.
D) the short-run aggregate supply curve and the aggregate demand curve shift in opposite directions.
Answer: A
Topic: Stagflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

90) Stagflation is associated with
A) cost-push inflation.
B) demand-pull inflation.
C) both cost-push inflation and demand-pull inflation.
D) neither cost-push inflation nor demand-pull inflation because it is a different concept altogether.
Answer: A
Topic: Stagflation
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

91) When the price level is rising and simultaneously real GDP is decreasing
A) the natural unemployment rate increases.
B) stagflation occurs.
C) there is an expansionary gap.
D) the Fed has increased the discount rate.
Answer: B
Topic: Stagflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

92) Stagflation results from
A) a leftward shift in the short-run aggregate supply curve.
B) a rightward shift in the aggregate demand curve.
C) a rightward shift in the short-run aggregate supply curve.
D) an increase in government expenditures financed by an increase in the quantity of money.
Answer: A
Topic: Stagflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

93) Stagflation is characterized by
A) an increase in both output and the price level.
B) a decrease in output and the price level.
C) an increase in the unemployment rate and an increase in the price level.
D) an economy which is growing at a rate equal to its historical average growth rate.
Answer: C
Topic: Stagflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

94) A one-time increase in the price of oil followed by a one-time increase in aggregate demand produces
A) continuing cost-push inflation.
B) continuing demand-pull inflation.
C) a one-time decrease in the price level.
D) a one-time increase in the price level.
Answer: D
Topic: Aggregate Demand Response
Skill: Conceptual
Status: Revised
AACSB: Reflective thinking

95) A cost-push inflation spiral results if the Fed's response to stagflation is to keep
A) decreasing aggregate demand.
B) decreasing aggregate supply.
C) increasing aggregate demand.
D) increasing aggregate supply.
Answer: C
Topic: A Cost-Push Inflation Process
Skill: Recognition
Status: Old
AACSB: Reflective thinking

96) During a cost-push inflation spiral, the money wage rate ________ and the quantity of money ________.
A) increases; increases
B) increases; does not change
C) does not change; increases
D) does not change; does not change
Answer: A
Topic: A Cost-Push Inflation Process
Skill: Recognition
Status: Old
AACSB: Reflective thinking

97) For a cost-push inflation to occur, oil price increases must be accompanied by
A) decreased investment spending.
B) lower personal tax rates.
C) increases in the quantity of money.
D) increases in government expenditures.
Answer: C
Topic: A Cost-Push Inflation Process
Skill: Recognition
Status: Old
AACSB: Reflective thinking

98) Oil prices increase sharply, raising the price level and decreasing real GDP. The Fed has an incentive to
A) increase the quantity of money in order to reduce unemployment.
B) decrease the quantity of money in order to reduce unemployment.
C) increase the quantity of money in order to reduce the price level.
D) increase the quantity of money in order to reduce the price level and unemployment.
Answer: A
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

99) Suppose oil prices rise and short-run aggregate supply decreases. If the Fed responds by increasing the quantity of money, then in the short run
A) real GDP increases and the price level falls.
B) real GDP increases and the price level rises even higher.
C) the Fed is more concerned about fighting inflation than unemployment.
D) None of the above answers is correct.
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

100) Suppose oil prices rise. The Fed can ________ the quantity of money to ________ the unemployment rate back to its natural rate.
A) increase; raise
B) increase; lower
C) decrease; raise
D) decrease; lower
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

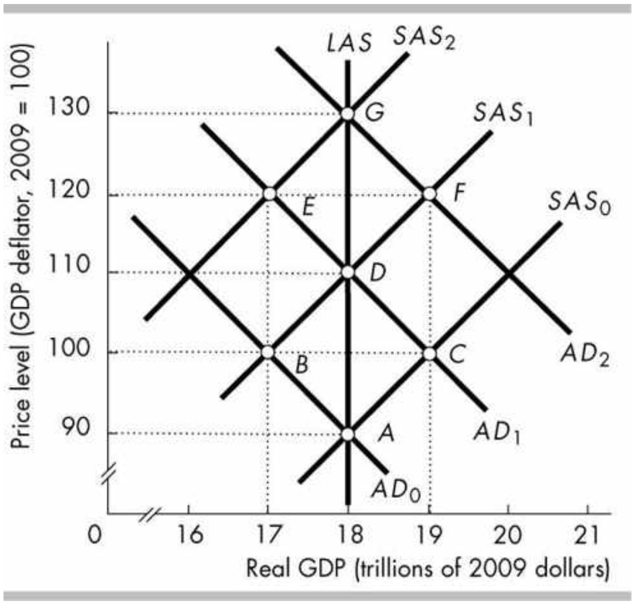
101) One example of cost-push inflation is an increase in
A) the money prices of raw materials followed by no government policy.
B) the money prices of raw materials followed by increases in the quantity of money.
C) the money prices of raw materials followed by decreases in the quantity of money.
D) government expenditure followed by increases in the quantity of money.
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

102) In a cost-push inflation,
A) increases in *AD* lead to increases in *SAS*.
B) decreases in *AD* lead to increases in *SAS*.
C) increases in *SAS* lead to decreases in *AD*.
D) decreases in *SAS* lead to increases in *AD*.
Answer: D
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

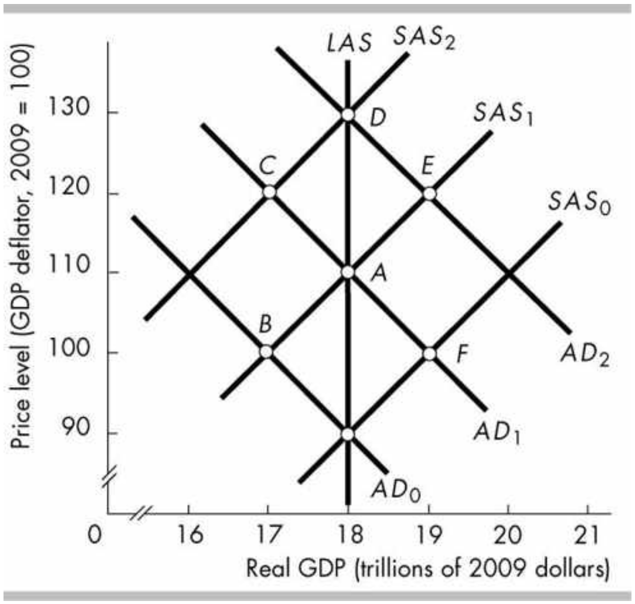
103) If the Fed responds to repeated decreases in the short-run aggregate supply with repeated increases in the quantity of money, the economy will be faced with
A) a one-time increase in prices.
B) continuous inflation.
C) alternating periods of inflation and deflation.
D) steady decreases in real GDP.
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

104) When there is a cost-push inflation
A) workers demand higher money wages because of higher price levels.
B) the short-run aggregate supply curve shifts rightward.
C) the aggregate demand curve shifts leftward because of the cost hikes.
D) None of the above answers is correct.
Answer: A
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

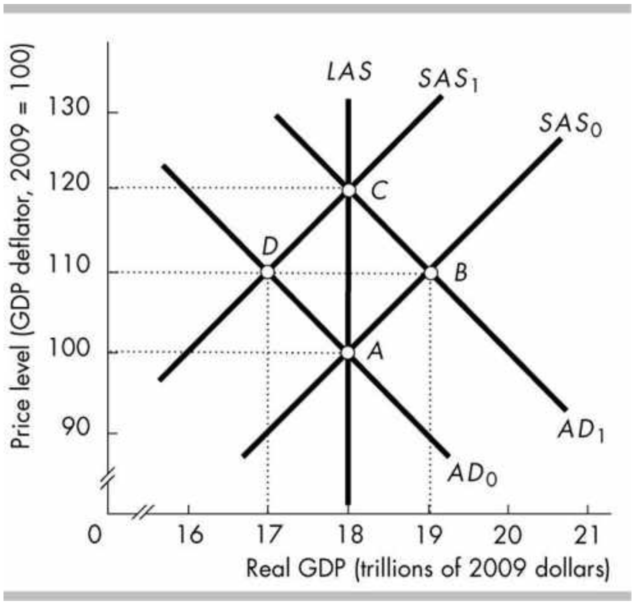
105) To prevent cost-push inflation
A) there must not be an excess demand for money.
B) interest rates must not rise.
C) there must not be an increase in government purchases.
D) the Fed must not let the quantity of money rise persistently.
Answer: D
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking



106) In the above figure, which path represents a cost-push inflation?
A) point *A* to *C* to *D* to *F* to *G*
B) point *A* to *B* to *D* to *E* to *G*
C) point *A* to *C* to *D* to *E* to *G*
D) point *A* to *B* to *D* to *F* to *G*
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking



107) The figure above shows the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for the U.S. economy. The economy is currently at point *A*. A cost-push rise in the price level will initially move the economy to point ________ and to point ________.
A) *E* when aggregate demand increases; *D* when the money prices of raw materials rise
B) *C* when the money prices of raw materials rise; *D* when aggregate demand increases
C) *F* when the money prices of raw materials rise; *E* when aggregate demand increases
D) *B* when aggregate demand decreases; *C* when the money prices of raw materials rise
Answer: B
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking



108) In the above figure, the economy is at point *A*. An increase in oil prices that sets off a cost-push inflation will initially move the economy from point *A* to point
A) *A*, that is, the economy does not change.
B) *B*.
C) *C*.
D) *D*.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

109) In the above figure, the economy is at point *A*. An increase in money wage rates that sets off a cost-push inflation will initially move the economy from point *A* to point
A) *A*, that is, the economy does not change.
B) *B*.
C) *C*.
D) *D*.
Answer: D
Topic: Initial Effect of a Decrease in Aggregate Supply
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

110) In the above figure, the economy is at point A. An increase in oil prices occurs. After the increase in oil prices, the Fed responds by increasing the quantity of money. The economy moves from point A to
A) D to point C.
B) B to point C.
C) C to point D.
D) C to point B.
Answer: A
Topic: A Cost-Push Inflation Process
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

111) During which decade did the United States suffer from the worst cost-push inflation?
A) 1960s
B) 1970s
C) 1980s
D) 1990s
Answer: B
Topic: Cost-Push Inflation in the United States
Skill: Recognition
Status: Old
AACSB: Reflective thinking

112) As far as cost-push inflation goes, the United States
A) has never experienced this type of inflation.
B) has experienced only this type of inflation.
C) experienced this type of inflation in the 1970s.
D) experienced this type of inflation during the 1990s.
Answer: C
Topic: Cost-Push Inflation in the United States
Skill: Recognition
Status: Old
AACSB: Reflective thinking

113) If people CORRECTLY anticipate an increase in aggregate demand, a result is
A) an increase in the real value of outstanding government debt.
B) workers demanding higher money wages to keep the real wage unchanged.
C) a lower rate of inflation in the current time period.
D) there are no predictable results associated with an anticipated increase in aggregate demand.
Answer: B
Topic: Anticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

114) The anticipated inflation rate is 5 percent. In order for purchasing power to remain constant, the money wage rate must rise by
A) 2 percent.
B) 5 percent.
C) 7 percent.
D) 12 percent.
Answer: B
Topic: Anticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

115) When workers and employers correctly anticipate an increase in inflation caused by an increase in aggregate demand
A) there will be no unemployment.
B) workers will overestimate the real wage rate.
C) unemployment will be at the natural rate.
D) workers will underestimate the real wage rate.
Answer: C
Topic: Anticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

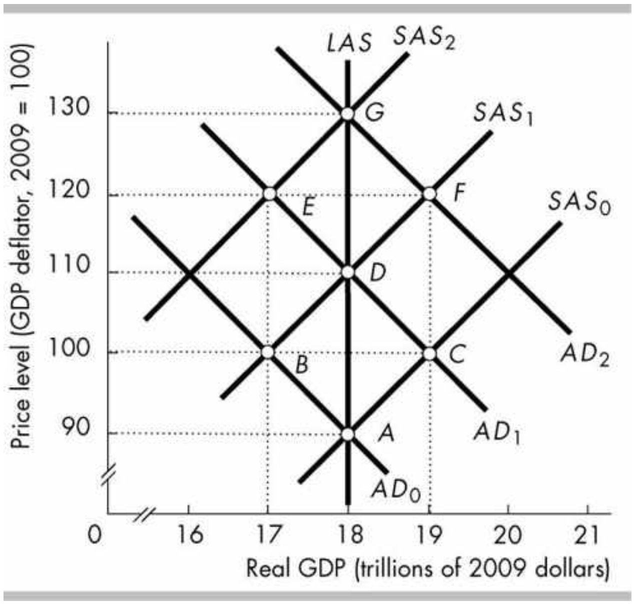
116) The economy is at potential GDP when people correctly anticipate an increase in government expenditure on goods and services. If the money wage rate adjusts immediately, then
A) real GDP and the price level will increase in the short run, but the real wage rate will fall.
B) real GDP remains at potential GDP.
C) real GDP, the price level, and the real wage rate all increase in the short run.
D) real GDP remains at potential GDP, there is no change in the price level, and the real wage rate rises in the short run.
Answer: B
Topic: Anticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

117) If the economy is initially at potential GDP and people correctly anticipate an increase in inflation so that their money wage rate adjusts immediately, then
A) only real GDP increases with no change in the price level.
B) only the price level rises with no change in real GDP.
C) both the price level and real GDP increase.
D) neither the price level nor real GDP increase.
Answer: B
Topic: Anticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

118) If people correctly expect an increase in aggregate demand, their money wage rate ________ immediately, and the *SAS* curve shifts ________.
A) rises; rightward
B) rises; leftward
C) falls; rightward
D) fall; leftward
Answer: B
Topic: Anticipated Inflation
Skill: Conceptual
Status: Revised
AACSB: Analytical thinking

119) Suppose aggregate demand increases by more than expected. Which of the following describes what will occur?
A) Real GDP will be greater than potential GDP.
B) The price level will increase.
C) Unemployment will fall.
D) All of the above answers are correct.
Answer: D
Topic: Unanticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

120) Suppose aggregate demand increases by less than expected. Which of the following describes what will occur?
A) Real GDP will be less than potential GDP.
B) The price level will fall.
C) Real GDP will be more than potential GDP.
D) Both answers A and B are correct.
Answer: A
Topic: Unanticipated Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking



121) In the above figure, if people correctly anticipate the increases in aggregate demand and the resulting inflation, the path will be from

A) point *A* to *C* to *D* to *F* to *G*.

B) point *A* to *B* to *D* to *E* to *G*.

C) point *A* to *D* to *G*.

D) point *A* to *B* to *D* to *F* to *G*.

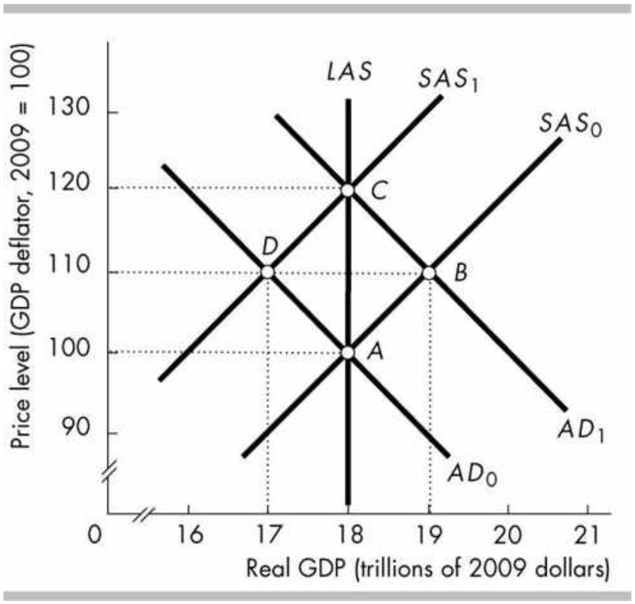
Answer: C

Topic: Anticipated Inflation

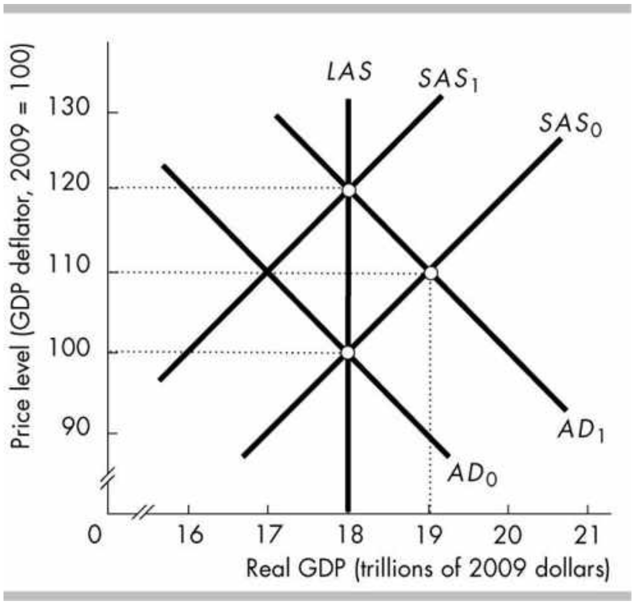
Skill: Analytical

Status: Revised

AACSB: Analytical thinking



122) In the above figure, the economy is initially at point *A*. If workers and firms correctly anticipate the increase in aggregate demand and the resulting inflation rate, the economy will move to point
A) *A*, that is, the price level and level of real GDP will not change.
B) *B*.
C) *C*.
D) *D*.
Answer: C
Topic: Anticipated Inflation
Skill: Analytical
Status: Revised
AACSB: Analytical thinking



123) An economy is at potential GDP and the price level is 100 in the figure above. If aggregate demand unexpectedly increases so that the aggregate demand curve shifts to AD_1, in the short run the inflation rate is
A) 0 percent a year.
B) 10 percent a year.
C) 20 percent a year.
D) More than 20 percent a year.
Answer: B
Topic: Unanticipated Inflation
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

124) An economy is in long-run equilibrium and the price level is 100 in the figure above. Aggregate demand increases and the aggregate demand curve shifts to AD_1. If the increase in aggregate demand is expected, then the inflation rate is
A) 0 percent a year.
B) 10 percent a year.
C) 20 percent a year.
D) More than 20 percent a year.
Answer: C
Topic: Anticipated Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

125) Suppose that the economy is at full employment and aggregate demand increases by more than it is anticipated to increase. Other things remaining the same,
A) long-run aggregate supply decreases.
B) real GDP remains at potential GDP.
C) real GDP increases above potential GDP.
D) real GDP decreases below potential GDP.
Answer: C
Topic: Unanticipated Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

126) A rational expectation is
A) a forecast devoid of all emotions.
B) a forecast which perfectly foretells the future.
C) the best possible forecast based upon all relevant information.
D) the forecast that automatically carries over from past forecasts.
Answer: C
Topic: Rational Expectation Theories
Skill: Recognition
Status: Old
AACSB: Reflective thinking

127) A rational expectation of inflation is
A) how economists make perfect forecasts of inflation.
B) how unexpected inflation affects the economy.
C) why unexpected inflation redistributes income.
D) a forecast of inflation that uses all relevant information.
Answer: D
Topic: Rational Expectation Theories
Skill: Recognition
Status: Old
AACSB: Reflective thinking

128) A rational expectation is
A) a correct forecast but it might not be the best available forecast.
B) always an incorrect forecast.
C) not necessarily correct but is the best available forecast.
D) necessarily correct because it is the best available forecast.
Answer: C
Topic: Rational Expectation Theories
Skill: Recognition
Status: Old
AACSB: Reflective thinking

129) If Samantha predicts future inflation based on rational expectations, then
A) her forecast of inflation will always be correct.
B) she uses all relevant information to forecast inflation.
C) she looks only to the past to help her predict future inflation.
D) she never under estimates inflation.
Answer: B
Topic: Rational Expectation Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

130) The Cleveland Federal Reserve Bank's estimate of expected inflation in 2013 is 1.5 percent. In 2013, if aggregate demand grows faster than expected, the actual inflation rate will
A) exceed 1.5 percent.
B) equal 1.5 percent because the actual inflation rate must equal the expected inflation rate.
C) be less than 1.5 percent.
D) None of the above answers are correct because there is no relationship between the actual inflation rate and aggregate demand.
Answer: A
Topic: Rational Expectation Theories
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

131) Which of the following would shift the aggregate demand curve leftward year after year?
A) a one-time tax cut
B) a one-time increase in government expenditures on goods and services
C) inflation
D) negative growth in the quantity of money
Answer: D
Topic: Study Guide Question, A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

132) Which of the following results in the aggregate demand curve shifting rightward year after year?
A) a one-time tax cut
B) a one-time increase in government expenditures on goods and services
C) inflation
D) growth in the quantity of money
Answer: D
Topic: Study Guide Question, A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

133) Demand-pull inflation occurs when
A) aggregate demand increases persistently.
B) aggregate supply and aggregate demand decrease persistently.
C) the government increases its expenditures.
D) oil prices increase substantially.
Answer: A
Topic: Study Guide Question, A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

134) In a demand-pull inflation, the *AD* curve shifts ________ and the *SAS* curve shifts ________.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: B
Topic: Study Guide Question, A Demand-Pull Inflation Process
Skill: Analytical
Status: Old
AACSB: Analytical thinking

135) A rise in the price level because of an increase in the money wage rate
A) definitely triggers a cost-push inflation.
B) definitely triggers a demand-pull inflation.
C) might trigger a cost-push inflation.
D) might trigger a demand-pull inflation.
Answer: C
Topic: Study Guide Question, Initial Effect of a Decrease in Aggregate Supply
Skill: Analytical
Status: Old
AACSB: Reflective thinking

136) A rise in the price level because of an increase in the price of oil
A) definitely triggers a cost-push inflation.
B) definitely triggers a demand-pull inflation.
C) might trigger a cost-push inflation.
D) might trigger a demand-pull inflation.
Answer: C
Topic: Study Guide Question, Initial Effect of a Decrease in Aggregate Supply
Skill: Analytical
Status: Old
AACSB: Reflective thinking

137) Which of the following statements about a cost-push inflation is CORRECT?
A) Cost-push inflation starts when an increase in aggregate demand "pushes" costs higher.
B) Cost-push inflation might start with a rise in the price of raw materials, but it requires increases in the quantity of money to persist.
C) To persist, cost-push inflation needs a continual series of cost hikes with no change in aggregate demand.
D) The United States has never experienced a cost-push inflation.
Answer: B
Topic: Study Guide Question, Cost-Push Inflation
Skill: Analytical
Status: Old
AACSB: Reflective thinking

3 Deflation

1) During a deflation, the inflation rate is
A) negative.
B) positive and rising.
C) positive and falling.
D) positive and not changing.
Answer: A
Topic: Deflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2) During a deflation, the price level is
A) negative.
B) positive and rising.
C) positive and falling.
D) positive and not changing.
Answer: C
Topic: Deflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

3) Deflation can start with
A) an increase in aggregate demand.
B) a decrease in aggregate demand.
C) a decrease in aggregate supply.
D) Both answers B and C are correct.
Answer: B
Topic: Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

4) The price level falls if
A) aggregate demand increases more rapidly than aggregate supply.
B) aggregate demand increases more slowly than aggregate supply.
C) aggregate demand increases and aggregate supply does not change.
D) neither aggregate demand nor aggregate supply change.
Answer: B
Topic: Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

5) Suppose the velocity of circulation increases by 2 percent and potential GDP grows by 2 percent. The trend inflation rate will equal zero if the quantity of money grows by
A) 0 percent.
B) 2 percent.
C) 4 percent.
D) -2 percent.
Answer: A
Topic: Deflation and the Quantity Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

6) Suppose the velocity of circulation increases by 2 percent and potential GDP grows by 4 percent. The trend inflation rate will equal zero if the quantity of money grows by
A) 0 percent.
B) 2 percent.
C) 4 percent.
D) -2 percent.
Answer: B
Topic: Deflation and the Quantity Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

7) Suppose the velocity of circulation increases by 4 percent and potential GDP grows by 3 percent. The trend inflation rate will equal zero if the quantity of money grows by
A) 0 percent.
B) 1 percent.
C) 4 percent.
D) 3 percent.
Answer: B
Topic: Deflation and the Quantity Theory
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

8) When Japan experienced deflation in the 1990s, Japan's real GDP
A) grew more rapidly than during any decade since the 1960s.
B) grew more slowly than in decades during which Japan experienced inflation.
C) did not grow at all.
D) Both answers B and C are correct.
Answer: B
Topic: Deflation in Japan
Skill: Analytical
Status: Old
AACSB: Analytical thinking

9) When Japan experienced deflation in the 1990s and 2000s, Japan's
A) capital stock grew more rapidly that during the decades that Japan experienced inflation..
B) real wage rate fell.
C) investment decreased so that its capital stock grew more slowly.
D) money growth rate soared.
Answer: C
Topic: Deflation in Japan
Skill: Analytical
Status: Old
AACSB: Analytical thinking

10) During an unanticipated deflation, the real wage rate ________ and employment ________.
A) falls; decreases
B) falls; increases
C) rises; decreases
D) rises; increases
Answer: C
Topic: Unanticipated Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

11) During a deflation, investment ________ and the rate of capital accumulation ________.
A) decreases; decreases
B) decreases; increases
C) increases; decreases
D) increases; increases
Answer: A
Topic: Unanticipated Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

12) During a deflation, investment ________ and the growth rate of potential GDP ________.
A) decreases; decreases
B) decreases; increases
C) increases; decreases
D) increases; increases
Answer: A
Topic: Unanticipated Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

13) During a deflation, the nominal interest rate is ________ and the velocity of circulation ________.
A) low; decreases
B) low; increases
C) high; decreases
D) high; increases
Answer: A
Topic: Unanticipated Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

14) To end a deflation, the government must
A) decrease government expenditures.
B) increase the quantity of money.
C) increase taxes.
D) increase the growth rate of the money stock.
Answer: A
Topic: Unanticipated Deflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

4 The Phillips Curve

1) Phillips curves show the relationship between the
A) nominal interest rate and the real interest rate.
B) expected rate of inflation and the nominal interest rate.
C) real interest rate and the unemployment rate.
D) unemployment rate and the inflation rate.
Answer: D
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2) Phillips curves describe the relationship between
A) aggregate expenditures and aggregate demand.
B) the quantity of money and interest rates.
C) unemployment and inflation.
D) aggregate demand and the price level.
Answer: C
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

3) A Phillips curve measures the relationship between
A) the unemployment rate and inflation.
B) the level of money wage rates and GDP.
C) unemployment and GDP.
D) inflation and GDP.
Answer: A
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

4) A Phillips curve shows the relationship between the
A) price level and real GDP.
B) unemployment rate and real GDP.
C) inflation rate and the unemployment rate.
D) inflation rate and real GDP.
Answer: C
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

5) For a given level of anticipated inflation and natural unemployment rate, the short-run Phillips curve shows the relationship between
A) potential GDP and real GDP.
B) real GDP growth and the unemployment rate.
C) inflation and money growth.
D) inflation and the unemployment rate.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

6) In 2012 the Cleveland Federal Reserve estimated that the expected inflation rate was 1.5 percent, the actual inflation rate was 2.1 percent, and the unemployment rate was 8.1 percent. A point on the short-run Phillips curve is the
A) difference between the actual and expected inflation rates (0.6 percent) and the unemployment rate of 8.1 percent.
B) inflation rate of 2.1 percent and the expected inflation rate of 1.5 percent.
C) expected inflation rate of 1.5 percent and the unemployment rate of 8.1 percent.
D) inflation rate of 2.1 percent and the unemployment rate of 8.1 percent.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

7) The short-run Phillips curve
A) slopes downward.
B) slopes upward.
C) is horizontal.
D) is vertical.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

8) Moving along a short-run Phillips curve
A) the price level is constant.
B) unemployment is constant.
C) the expected inflation rate is constant.
D) the inflation rate is constant.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

9) Which of the following is held constant when moving along a short-run Phillip's curve?
A) the inflation rate
B) the unemployment rate
C) the expected inflation rate
D) the growth rate of the quantity of money
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

10) The short-run Phillips curve shows the tradeoff between ________, holding the expected inflation rate and the natural unemployment rate constant.
A) the price level and real GDP
B) inflation and unemployment
C) the price level and unemployment
D) inflation and employment
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

11) The short-run Phillips curve shows a
A) positive relationship between the quantity of money and interest rates.
B) positive relationship between the price level and real GDP.
C) negative relationship between interest rates and the price level.
D) negative relationship between the unemployment rate and the inflation rate.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

12) In the short run, an unexpected increase in the inflation rate leads to
A) a higher unemployment rate.
B) a decrease in aggregate demand.
C) a lower unemployment rate.
D) workers thinking the money wage rate has fallen.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

13) Moving along the short-run Phillips curve indicates
A) that higher inflation leads to a higher unemployment rate.
B) that higher unemployment leads to a higher inflation rate.
C) a tradeoff between inflation and unemployment so that higher inflation is related to lower unemployment.
D) that the natural unemployment rate falls when the inflation rate rises.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

14) Movements upward along the short-run Phillips curve result from
A) expected increases in the inflation rate.
B) unexpected increases in the inflation rate.
C) expected decreases in the inflation rate.
D) unexpected decreases in the inflation rate.
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

15) If the unemployment rate initially equals its natural rate, then if the inflation rate rises above its expected rate, the unemployment rate
A) equals the natural rate.
B) remains constant.
C) falls below its natural rate.
D) rises above its natural rate.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

16) Along a short-run Phillips curve, suppose the expected inflation rate is 6 percent. If the actual inflation rate turns out to be 8 percent, then
A) there is a movement upward along the short-run Phillips curve.
B) there is a movement downward along the short-run Phillips curve.
C) there is a downward shift of the short-run Phillips curve.
D) None of the above answers are correct.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

17) Suppose that the expected inflation rate is 8 percent and the unemployment rate is 3 percent. If the actual inflation rate rises to 10 percent and the expected inflation rate does not change, then
A) the short-run Phillips curve will shift upward.
B) the short-run Phillips curve will shift downward.
C) there will be a movement along the short-run Phillips curve.
D) the natural unemployment rate will rise.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

18) Suppose that last year the economy of Suffera was experiencing an expected inflation rate of 8 percent and unemployment rate of 12 percent. An unexpected increase in the inflation rate would
A) increase the unemployment rate.
B) increase the inflation rate and decrease the unemployment rate.
C) increase the inflation rate but have no effect on the unemployment rate.
D) None of the above answers is correct.
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

19) Which of the following leads to a rightward shift in the short-run Phillips curve?
I. a reduction in the expected inflation rate
II. an increase in the natural unemployment rate
A) I only
B) II only
C) I and II
D) neither I nor II
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

20) An increase in the expected inflation rate shifts the
A) short-run Phillips curve downward.
B) short-run Phillips curve upward.
C) long-run Phillips curve upward.
D) long-run Phillips curve downward.
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

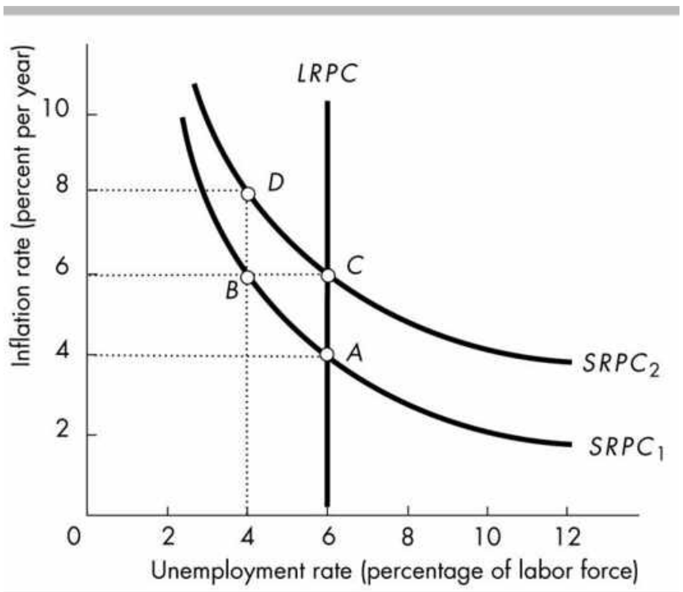
21) An increase in the expected inflation rate leads to ________ the short-run Phillips curve.
A) a movement upward along
B) a movement downward along
C) an upward shift of
D) a downward shift of
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

22) Which of the following leads to a downward shift in the short-run Phillips curve?
A) People expected inflation to be 5 percent last year and now expect inflation to be 3 percent this year.
B) People expect the unemployment rate to increase.
C) The long-run Phillips curve shifts rightward.
D) Unexpected inflation increases.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

23) Suppose that the expected inflation rate is 12 percent and the unemployment rate is 5 percent. If the expected inflation rate increases to 13 percent, then
A) the short-run Phillips curve will shift upward.
B) the short-run Phillips curve will shift downward.
C) there will be a movement along the short-run Phillips curve.
D) the natural unemployment rate will rise.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

24) The Cleveland Federal Reserve Bank's estimate of expected inflation has fallen from 3.5 percent in 2000 to 1.5 percent in 2013. This fall means that
A) the short-run Phillips curve shifted upward.
B) the short-run Phillips curve shifted downward.
C) there was a movement along the short-run Phillips curve.
D) the natural unemployment rate increased.
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

25) The government estimates that the natural unemployment rate has increased from 4.8 percent in 2006 to 5.2 percent in late 2012. If these estimates are accurate, the short-run Phillips curve has
A) shifted rightward.
B) shifted leftward.
C) not shifted.
D) None of the above answers are correct because the effect on the short-run Phillips curve is ambiguous.
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking



26) In the above figure, suppose that the economy is at point *A*. An unexpected increase in the inflation rate to 6 percent will result in a movement to point
A) *A*, that is, there is no movement.
B) *B*.
C) *C*.
D) *D*.
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

27) In the above figure, suppose that the economy is at point *A*. An expected increase in the inflation rate to 6 percent will result in a movement to point
A) *A*, that is, there is no movement.
B) *B*.
C) *C*.
D) *D*.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

28) The long-run Phillips curve shows the relationship between the inflation rate and the unemployment rate when the
A) real interest rate equals the nominal interest rate.
B) real interest rate is zero.
C) actual inflation rate equals the expected inflation rate.
D) inflation rate is zero.
Answer: C
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

29) The long-run Phillips curve is
A) vertical at potential GDP.
B) the horizontal sum of the short-run Phillips curves.
C) vertical at the natural unemployment rate.
D) the vertical sum of the short-run Phillips curves.
Answer: C
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

30) The long-run Phillips curve is
A) horizontal at the expected inflation rate.
B) vertical at the natural unemployment rate.
C) horizontal at the actual inflation rate.
D) vertical at the actual inflation rate.
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

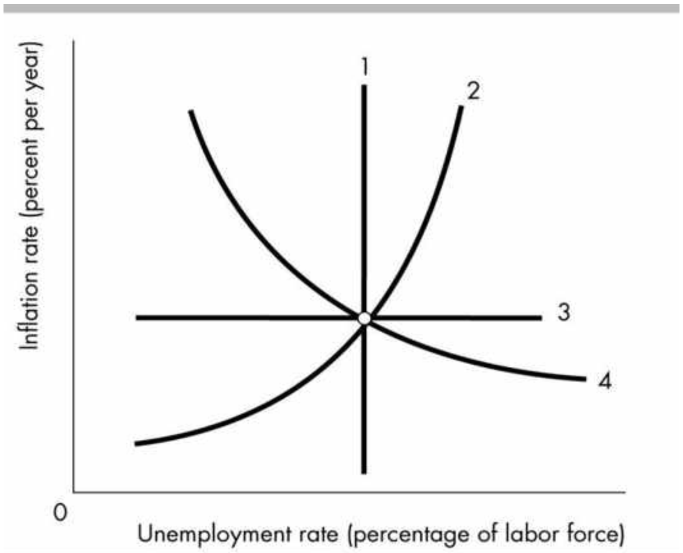
31) Along the long-run Phillips curve
A) actual inflation is greater than expected inflation.
B) actual inflation is equal to expected inflation.
C) actual inflation is less than expected inflation.
D) None of the above answers is correct.
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

32) The long-run Phillips curve shows that in the long run, policymakers can
A) lower unemployment if they are willing to accept more inflation forever.
B) lower inflation if they are willing to accept higher unemployment forever.
C) choose the unemployment rate but not the inflation rate.
D) lower inflation without increasing unemployment.
Answer: D
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

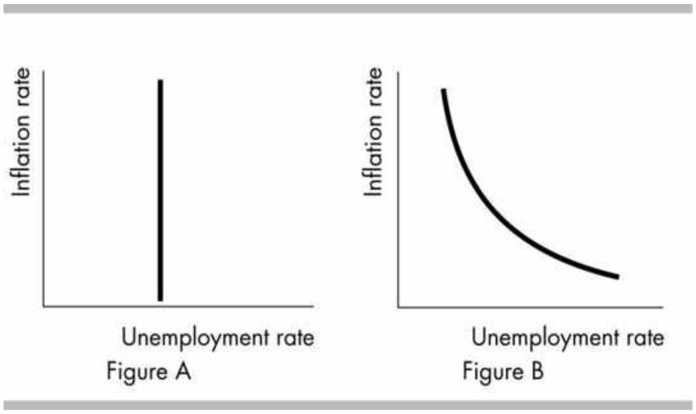
33) The position of the long-run Phillips curve is determined by
A) the quantity of money.
B) the natural unemployment rate.
C) the inflation rate.
D) the expected inflation rate.
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

34) The Cleveland Federal Reserve Bank's estimate of expected inflation has fallen from 3.5 percent in 2000 to 1.5 percent in 2013. This fall means that
A) the long-run Phillips curve shifted leftward.
B) the long-run Phillips curve shifted rightward.
C) the long-run Phillips curve shifted downward.
D) None of the above answers are correct because a change in the expected inflation rate does not shift the long-run Phillips curve.
Answer: D
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

35) Which of the following statements about the long-run Phillips curve is <u>CORRECT</u>?
A) The long-run Phillips curve is horizontal.
B) The long-run Phillips curve shifts leftward if the natural unemployment rate decreases.
C) The long-run Phillips curve shifts rightward and upward if the expected inflation rate increases.
D) The long-run Phillips curve shifts leftward if the natural unemployment rate increases.
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking



36) In the above figure, which of the following curves represents the long-run Phillips curve?
A) 1
B) 2
C) 3
D) 4
Answer: A
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Analytical thinking



37) Which of the diagrams in the above figure best illustrates a short-run Phillips curve?
A) Figure A
B) Figure B
C) both Figure A and Figure B
D) neither Figure A nor Figure B
Answer: B
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

38) In Figure B above, which of the following is being held constant while moving along the curve in the figure?
A) the expected inflation rate
B) the natural unemployment rate
C) the *AD* curve
D) Both answers A and B are correct.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Revised
AACSB: Analytical thinking

39) Which of the diagrams in the above figure best illustrates a long-run Phillips curve?
A) Figure A
B) Figure B
C) both Figure A and Figure B
D) neither Figure A nor Figure B
Answer: A
Topic: The Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

40) The short-run Phillips curve intersects the long-run Phillips curve at the
A) natural interest rate.
B) nominal interest rate.
C) natural inflation rate.
D) expected inflation rate.
Answer: D
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

41) The Cleveland Federal Reserve Bank estimates the expected inflation rate is 1.5 percent in 2013. This estimate means that
A) the long-run and short-run Phillips curve cross at an inflation rate of 1.5 percent.
B) the long-run Phillips curve is vertical at 1.5 percent.
C) the short-run Phillips curve is vertical at 1.5 percent.
D) the short-run Phillips curve shifts upward by 1.5 percentage points per year.
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

42) The short-run Phillips curve and the long-run Phillips curve intersect at the ________ and ________.
A) expected inflation rate; the expected unemployment rate
B) expected inflation rate; the natural unemployment rate
C) natural inflation rate; the expected employment rate
D) expected inflation rate; the expected employment rate
Answer: B
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

43) An increase in the expected inflation rate shifts
A) both the short-run and the long-run Phillips curves upward.
B) the short-run but not the long-run Phillips curve upward.
C) the long-run but not the short-run Phillips curve upward.
D) neither the short-run nor the long-run Phillips curve.
Answer: B
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

44) A decrease in the expected inflation rate shifts the short-run Phillips curve
A) downward and shifts the long-run Phillips curve leftward.
B) upward and shifts long-run Phillips curve rightward.
C) downward and creates a movement downward along the long-run Phillips curve.
D) upward and creates a movement upward along the long-run Phillips curve.
Answer: C
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

45) An increase in the natural unemployment rate shifts
A) both the short-run and the long-run Phillips curves rightward.
B) the short-run but not the long-run Phillips curve rightward.
C) the long-run but not the short-run Phillips curve rightward.
D) neither the short-run nor the long-run Phillips curve.
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

46) A change in the natural unemployment rate
A) shifts only the short-run Phillips curve.
B) causes a movement along the short-run Phillips curve.
C) shifts only the long-run Phillips curve.
D) shifts both the short-run and long-run Phillips curves.
Answer: D
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

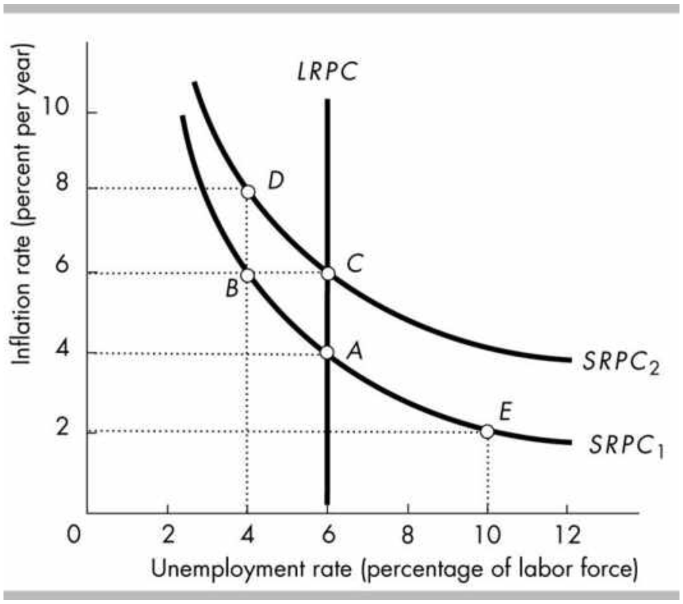
47) If the natural unemployment rate increases, then the short-run Phillips curve shifts ________ and the long-run Phillips curve shifts ________.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

48) The government estimates that the natural unemployment rate has increased from 4.8 percent in 2006 to 5.2 percent in late 2012. If these estimates are accurate, the short-run Phillips curve has shifted ________ and the long-run Phillips curve has shifted ________.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

Inflation rate (percent per year)	Unemployment rate (percent)
8	3
6	4
4	5
2	6

49) An economy's natural unemployment rate is 4 percent. The table above gives some points on the economy's short-run Phillips curve. When the unemployment rate is 4 percent
A) actual inflation is greater than expected inflation.
B) actual inflation is less than expected inflation.
C) and the inflation rate is 6 percent a year, the short-run and long-run Phillips curves intersect.
D) and the expected inflation rate is 8 percent a year, the short-run Phillips curve shifts downward.
Answer: C
Topic: The Short-Run Phillips Curve and the Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

50) An economy's natural unemployment rate is 4 percent. The table above gives some points on the economy's short-run Phillips curve. If the expected inflation rate becomes 8 percent per year, then the
A) short-run Phillips curve shifts upward.
B) long-run Phillips curve shifts rightward.
C) long-run Phillips curve shifts leftward.
D) short-run Phillips curve shifts downward.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Analytical thinking



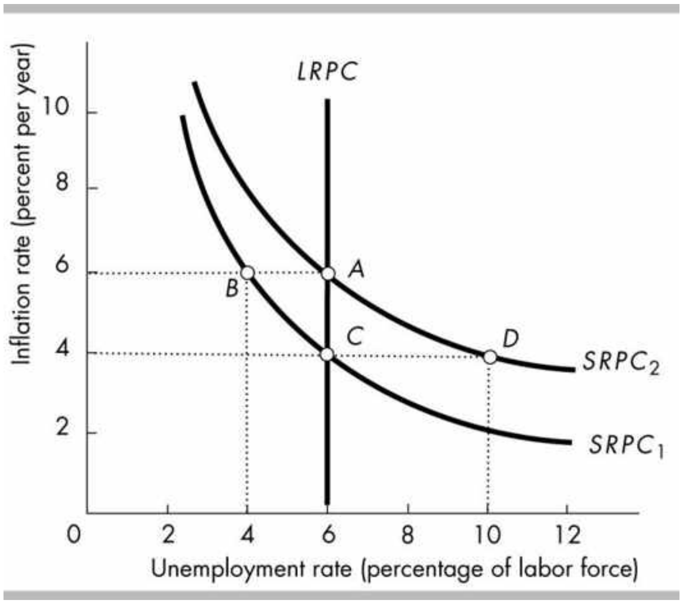
51) In the above figure, suppose that the economy currently is at point *A*. If the inflation rate falls and this fall is unanticipated by the public, the economy moves to a point such as point
A) *B*.
B) *C*.
C) *D*.
D) *E*.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

52) In the above figure, suppose that the economy currently is at point *A*. If the inflation rate rises and this rise is <u>NOT</u> expected by the public, the economy moves to a point such as point
A) *B*.
B) *C*.
C) *D*.
D) *E*.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

53) In the above figure, what might have shifted the short-run Phillips curve from $SRPC_1$ to $SRPC_2$ while leaving the long-run Phillips curve unchanged at *LRPC*?
A) The natural unemployment rate increased.
B) The natural unemployment rate decreased.
C) The expected inflation rate increased.
D) The expected inflation rate decreased.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

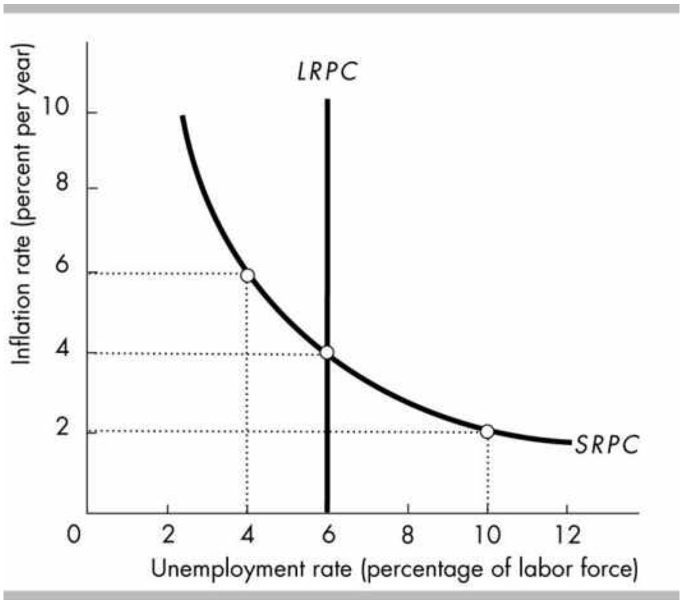
54) In the above figure, suppose that the economy currently is at point *A*. If the inflation rate rises and this rise is anticipated by the public, the economy moves to a point such as point
A) *B*.
B) *C*.
C) *D*.
D) *E*.
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

55) In the above figure, suppose that the economy is at point *C*. If the inflation rate is lower than expected,
A) the *LRPC* will shift rightward.
B) the *SRPC* will shift downward.
C) the *SRPC* will shift upward.
D) Neither the *LRPC* nor the *SRPC* will shift.
Answer: D
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking



56) In the above figure, the economy is at point *A*. The inflation rate unexpectedly falls by two percentage points. As a result, the economy moves to point
A) *A*, that is, there is no movement.
B) *B*.
C) *C*.
D) *D*.
Answer: D
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

57) In the above figure, the economy is at point *A*. The inflation rate falls by two percentage points and people correctly expected the fall. As a result, the economy moves to point
A) *A*, that is, there is no movement.
B) *B*.
C) *C*.
D) *D*.
Answer: C
Topic: The Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking



58) The figure above shows an economy's Phillips curves. Currently, the inflation rate is 6 percent a year. The natural unemployment rate is ________ percent and the expected inflation rate is ________ percent a year.
A) 6; 6
B) 6; 10
C) 4; 6
D) 6; 4
Answer: D
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

59) The figure above shows an economy's Phillips curves. Currently, the inflation rate is 6 percent a year. If inflation expectations remain unchanged, the current unemployment rate is
A) less than the natural rate.
B) greater than the natural rate.
C) equal to the natural rate.
D) 6 percent.
Answer: A
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Analytical thinking

60) The short-run Phillips curve shows the relationship between
A) the price level and real GDP in the short run.
B) the price level and unemployment in the short run.
C) inflation and unemployment when expected inflation equals the actual inflation.
D) inflation and unemployment when expected inflation does not change.
Answer: D
Topic: Study Guide Question, The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

61) The short-run Phillips curve shows the ________ relationship between ________.
A) negative; unemployment and real GDP
B) positive; unemployment and real GDP
C) negative; inflation and unemployment
D) positive; real GDP and inflation
Answer: C
Topic: Study Guide Question, The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

62) The long-run Phillips curve shows the relationship between
A) the price level and real GDP in the long run.
B) the price level and unemployment in the long run.
C) inflation and unemployment when expected inflation equals the actual inflation.
D) inflation and unemployment when expected inflation does not change.
Answer: C
Topic: Study Guide Question, The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

63) A decrease in the natural unemployment rate shifts the long-run Phillips curve ________ and ________ the short-run Phillips curve.
A) rightward; does not shift
B) leftward; shifts rightward
C) rightward; shifts rightward
D) leftward; shifts leftward
Answer: D
Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

64) A rise in the expected inflation rate leads to ________ in the long-run Phillips curve and ________ in the short-run Phillips curve.
A) an upward shift; no shift
B) a leftward shift; an upward shift
C) no shift; no shift
D) no shift; an upward shift
Answer: D
Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

65) A decrease in the expected inflation rate leads to ________ in the long-run Phillips curve and ________ in the short-run Phillips curve.
A) an upward shift; no shift
B) a leftward shift; an upward shift
C) no shift; no shift
D) no shift; a downward shift
Answer: D
Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

5 News Based Questions

1) The data below show data for Germany including real GDP (in billions of euros) and the price level.

	Real GDP	Price Level
2002	2088	102.6
2003	2083	103.6
2004	2105	106
2005	2121	108.2
2006	2182	109.7
2007	2237	109.5

In which of the following year(s) did Germany experience inflation?
A) 2003, 2004, 2005 and 2006
B) 2006 and 2007
C) 2007
D) 2002, 2005 and 2006 only
Answer: A
Topic: Inflation Rate
Skill: Analytical
Status: Old
AACSB: Reflective thinking

2) "UK Inflation Surges to 16-year High"
According to the story, "High inflation in July will also lead to ... "further rises next January ..." Economists also noted that inflation may get worse because the current data did not yet include "announced rises in gas and electricity prices."

www.ft.com, 8/12/2008

The story reflects the concept of
A) cost-push inflation.
B) the short-run Phillips curve.
C) demand-pull inflation.
D) the long-run Phillips curve.
Answer: A
Topic: Cost-Push Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

3) "Inflation Gives Saudis Food for Thought"
"My boss sent me back to return the milk – it's too expensive," said the Pakistani driver for a middle-class Saudi family at the checkout counter of the Al-Othaim supermarket. ...Saudi Arabia is enjoying an unprecedented economic boom ...as sectors [have] increased activity to meet the big internal demand."
www.ft.com, 1/18/2008

The type of inflation described in the story
A) begins with stagflation.
B) starts with an increase in aggregate demand.
C) is the result of money wage rate spiral.
D) starts with a decrease in aggregate demand.
Answer: B
Topic: Demand-Pull Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

4) "Inflation Gives Saudis Food for Thought"
"My boss sent me back to return the milk – it's too expensive," said the Pakistani driver for a middle-class Saudi family at the checkout counter of the Al-Othaim supermarket. ...Saudi Arabia is enjoying an unprecedented economic boom ...as sectors [have] increased activity to meet the big internal demand."
www.ft.com, 1/18/2008

The story describes
A) cost-push inflation.
B) demand-pull inflation.
C) a rightward shift in the short-run Phillips curve.
D) stagflation.
Answer: B
Topic: Demand-Pull Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

5) "Shoe Industry under Pressure Amid Rising Costs "
Rising costs have forced about 15 per cent of shoe manufacturers in a major south China industrial centre to shut down or relocate in the past year... [the firms have] identified rising wages as a key factor behind the closures and relocations from Dongguan...The problems in the footwear industry reflect broader issues affecting manufacturers across China's Pearl River Delta..."

www.ft.com, 2/26/2008

As the same pressures affect other industries across China, we expect to see
A) demand-pull inflation.
B) a combination of cost-push and demand-pull inflation.
C) cost-push inflation.
D) a downward movement along the short-run Phillips curve.
Answer: C
Topic: Cost-Push Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

6) "Shoe Industry under Pressure Amid Rising Costs"
Rising costs have forced about 15 per cent of shoe manufacturers in a major south China industrial centre to shut down or relocate in the past year... [the firms have] identified rising wages as a key factor behind the closures and relocations from Dongguan...The problems in the footwear industry reflect broader issues affecting manufacturers across China's Pearl River Delta..."

www.ft.com, 2/26/2008

Using an *AS*/*AD* framework to describe the events in the story, there would be a
A) leftward shift in the *AD* curve.
B) leftward shift in the *SAS* curve.
C) rightward shift in the *AD* curve.
D) rightward shift in the *SAS* curve.
Answer: B
Topic: Cost-Push Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

7) "All for One, but None for All"
In an article regarding how Great Britain and France are addressing the economic crisis in 2008, Britain's prime minister "is eager to encourage consumer spending" while France's president "wants to boost investment in both the private and public sectors." Both leaders are concerned because "hardly a day goes by without some manufacturing company announcing painful restructuring, plant closures or temporary lay-offs."

www.ft.com, 11/24/2008

If the governments can increase consumption or investment while holding the expected inflation constant, there would be
A) a rightward shift of the long-run Phillips curve.
B) a movement down along the short-run Phillips curve
C) a movement up along the short-run Phillips curve.
D) a leftward shift of the *AD* curve.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

8) "All for One, but None for All"
In an article regarding how Great Britain and France are addressing the economic crisis in 2008, Britain's prime minister "is eager to encourage consumer spending" while France's president "wants to boost investment in both the private and public sectors." Both leaders are concerned because "hardly a day goes by without some manufacturing company announcing painful restructuring, plant closures or temporary lay-offs."

www.ft.com, 11/24/2008

If consumption and investment are increased by the governments' policies, we would expect ________ and a ________ the short-run Phillips curve.
A) increase in aggregate demand; rightward shift of
B) increase in aggregate demand; movement up along
C) movement up along the *AD* curve; rightward shift of
D) movement down along the *AD* curve; movement down along
Answer: B
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

9) In a speech to Asia Pacific Economic Cooperation summit in Peru in November 2008, President Hu of China commented on his country's $586 billion fiscal stimulus plan by saying, "Instead of relying mainly on investment and export we will adopt a coordinated approach that combines consumption, investment and export to boost the economy. And instead of relying heavily on higher consumption of material resources we will achieve development by making scientific and technological progress." If his country's plan works and the expected inflation rate does not change, there will be a
A) movement up along the short-run Phillips curve.
B) movement down along the short-run Phillips curve.
C) rightward shift of the long-run Phillips curve.
D) leftward shift of the long-run Phillips curve.
Answer: A
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

10) In late 2008, Great Britain's inflation rate fell from 5.2 percent to 4.5 percent while unemployment was increased from 5.4 percent to 6 percent. These changes would be shown as a
A) leftward shift of the long-run Phillips curve.
B) movement up along the short-run Phillips curve.
C) movement down the short-run Phillips curve.
D) rightward shift of the long-run Phillips curve.
Answer: C
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

11) As world economies recover from the financial crisis in 2008 and 2009, the U.S. economy returns to full employment and expected inflation equals actual inflation
A) there will be a movement back to the long-run Phillips curve.
B) the long-run Phillips curve will shift leftward.
C) there will be a movement upward along the short-run Phillips curve.
D) there will be a movement downward along the short-run Phillips curve.
Answer: A
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

12) A story from www.ft.com (1/31/2005) describing Ireland's transformation to a prosperous economy noted that "Ireland's story is unique: a small, English-speaking, non-industrialized country on the edge of Europe was able to secure structural funds from the EU, cut taxes, deregulate faster than its neighbours and attract lots of foreign companies in the process."

If the natural rate of unemployment in Ireland decreased as a result of these policies, then ________ would shift ________.
A) the long-run and short-run Phillips curves; rightward
B) the long-run and short-run Phillips curves; leftward
C) only the long-run Phillips curve; leftward
D) only the short-run Phillips curve; rightward
Answer: B
Topic: The Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

13) Over the last several years, the money supply in Indonesia as increased by 9 percent in 2003 to 14 percent in 2005 and 23 percent in 2007. At the same time, real GDP has grown steadily at over 4 percent annually.
These changes would be shown as
I. rightward shifts of the *AD* curve
II. a movement down along the short-run Phillips curve
III. rightward shifts of the *LAS* curve
A) I and III.
B) I, II and III.
C) II only.
D) I only.
Answer: A
Topic: The Business Cycle
Skill: Analytical
Status: Old
AACSB: Analytical thinking

14) In a story from www.Forbes.com (5/30/2003), it was reported that the Chief Technology Officer of the U.S. plans for the country to spend $58.1 billion on technology that year. He was planning to buy technology from Cisco Systems, Oracle and Sun Microsystems in addition to other software makers.

This story reports on technological change which is the stressed in the ________ of business cycles.
A) real business cycle theory
B) new Keynesian cycle theory
C) new classical cycle theory
D) monetarist cycle theory
Answer: A
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

6 Essay Questions

1) What is demand-pull inflation?
Answer: An inflation that starts from an initial increase in aggregate demand is a demand-pull inflation.
Topic: Demand-Pull Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2) What are sources that can start a demand-pull inflation?
Answer: Demand-pull inflation starts with an increase in aggregate demand. This increase can arise by increases in the quantity of money, increases in government expenditure, or increases in net exports because any of these three shift increase aggregate demand and shift the *AD* curve rightward. The increase in aggregate demand leads to a higher price level and, temporarily, a higher level of real GDP. If the economy began at full employment, then temporarily the level of real GDP will be above potential. In the long run, however, the money wage rate rises to offset the increase in the price level, so the short-run aggregate supply decreases and the *SAS* curve shifts leftward. The decrease in aggregate supply also raises the price level. So the only way the inflation can continue is if aggregate demand continues to increase.
Topic: Demand-Pull Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

3) Describe how a demand-pull inflation can occur.
Answer: Demand-pull inflation starts from an initial increase in aggregate demand. But if this increase is a one-time only event, the result is a higher price level but not inflation. For inflation to occur, aggregate demand needs to continue to increase. Continuing increases in the quantity of money result in continuing increases in aggregate demand, so monetary growth is necessary for a demand-pull inflation.
Topic: Demand-Pull Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

4) What was the U.S. experience with demand pull inflation during the 1960s and early 1970s?
Answer: The United States experienced demand pull inflation notably during the late 1960s. Government spending increased enormously during the decade because of spending on the Vietnam War and on social programs related to the Great Society of Lyndon Johnson. These increases in spending were matched by increases in the quantity of money. The *AD* curve shifted rightward, driving prices higher. The decade had begun with inflation of 2 percent per year. By the end of the decade the rate was 5 percent and would reach 10 percent by 1975.
Topic: Demand-Pull Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

5) What is a cost-push inflation?

Answer: A cost-push inflation is an inflation that starts as a result of an increase in costs. Money wage rates and the cost of raw materials are the main sources of cost-push inflation.

Topic: Cost-Push Inflation
Skill: Recognition
Status: Old
AACSB: Reflective thinking

6) What factors can start a cost-push inflation? What must the Fed's response be for the inflation to continue?

Answer: Cost push inflation starts with a decrease in the short-run aggregate supply, that is, a leftward shift of the *SAS* curve. The decrease in short-run aggregate supply can be the result of an increase in the money wage rate or an increase in the money price of other raw materials. In either instance firms' costs have risen and they respond by decreasing production, which decreases the short-run aggregate supply. The dilemma for the Fed is that the decreases in short-run aggregate supply means that real GDP falls below potential GDP and the price level rises. If the Fed responds by increasing the quantity of money in order to increase aggregate demand and move real GDP back to potential GDP, the price level will rise still higher. And if the initial agent that raised costs responds to the higher price level by again raising its costs, then a cost-push inflation might well occur.

Topic: Cost-Push Inflation
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

7) What is the Phillips curve? Discuss both the short-run and long-run Phillips curve.

Answer: In general, a Phillips curve shows a relationship between the inflation rate and the unemployment rate. There is a short-run Phillips curve and a long-run Phillips curve. Moving along a short-run Phillips curve, expected inflation and the natural unemployment rate are constant. The short-run Phillips curve shows the relationship between the inflation rate and unemployment rate: a higher inflation rate results in a lower unemployment rate. The long-run Phillips curve shows the relationship between the inflation rate and unemployment rate when the inflation rate equals the expected inflation rate. Moving along the long-run Phillips curve there is no tradeoff between the inflation rate and the unemployment rate: a higher inflation rate has no effect on unemployment rate, which remains equal to the natural unemployment rate.

Topic: Inflation and Unemployment: The Phillips Curve
Skill: Analytical
Status: Old
AACSB: Written and oral communication

8) "The short-run Phillips curve shows the relationship between real GDP and inflation." Is the previous statement correct or incorrect? Briefly explain you answer.

Answer: The statement is incorrect. The short-run Phillips curve shows the relationship between the unemployment rate and the inflation rate.

Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

9) Define and describe the short-run Phillips curve.
Answer: The short-run Phillips curve shows the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate do not change. The short-run Phillips curve is downward sloping, indicating that there is a tradeoff between inflation and unemployment: inflation can be lowered only at the cost of higher unemployment and unemployment can be lowered only at the cost of higher inflation.
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

10) "The short-run Phillips curve is vertical at the natural unemployment rate." Is the previous statement correct or incorrect?
Answer: The statement is incorrect. The *LONG-RUN* Phillips curve is vertical at the natural unemployment rate but the SHORT-RUN Phillips curve is downward sloping.
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

11) What does the short-run Phillips curve indicate about the relationship between inflation and unemployment?
Answer: Because the slope of the short-run Phillips curve is negative, the short-run Phillips curve indicates that a tradeoff between inflation and unemployment exists. Lower inflation can be obtained, but the price is higher unemployment. Similarly, lower unemployment is possible but the price is higher inflation.
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

12) "The short-run Phillips curve shifts leftward when the inflation rate rises." Is the previous statement correct or incorrect?
Answer: The statement is incorrect. An increase in the inflation rate leads to a movement along the short-run Phillips curve.
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

13) If the short-run Phillips curve shifts rightward, what happens to the relationship between inflation and unemployment? If the short-run Phillips curve shifts leftward, what happens to the relationship between inflation and unemployment?
Answer: A rightward shift of the short-run Phillips curve worsens the tradeoff between inflation and unemployment. With the rightward shift, a given level of inflation is now associated with a higher unemployment rate, or stated another way, a given unemployment rate is now associated with a higher inflation rate. A leftward shift of the short-run Phillips curve improves the tradeoff between inflation and unemployment. With the leftward shift, a given level of inflation is now associated with a lower unemployment rate, or stated another way, a given unemployment rate is now associated with a lower inflation rate.
Topic: The Short-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

14) Explain how the expected inflation rate affects the short-run Phillips curve. Be sure to mention the role played by the money wage rate.
Answer: When the expected inflation rate falls, the short-run Phillips curve shifts downward and when the expected inflation rate rises, the short-run Phillips curve shifts upward. To see why the expected inflation rate affects the short-run Phillips curve, the key is that the expected inflation rate affects the money wage rate. Suppose the expected inflation rate increases. As a result, labor contracts will now specify higher money wage rates in the present and in the future. In turn, the higher the money wage rates, the more the aggregate supply decreases. And, the more the aggregate supply decreases, the lower the level of employment and the higher the level of unemployment. Therefore for a given price level and inflation rate, an increase in the expected inflation rate increases the unemployment rate, which means that the short-run Phillips curve shifts higher.
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

15) "The long-run Phillips curve is downward sloping." Is the previous statement correct or incorrect?
Answer: The statement is incorrect because the long-run Phillips curve is vertical. The short-run Phillips curve is downward sloping.
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

16) "The long-run Phillips curve is vertical at the expected inflation rate." Is the previous statement correct or incorrect?
Answer: The statement is incorrect because the long-run Phillips curve is vertical at the natural unemployment rate.
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

17) In the long run, what is the tradeoff between inflation and unemployment? Explain your answer using Phillips curve analysis.
Answer: In the long run, there is no tradeoff between inflation and unemployment. In particular, in the long run, changes in the inflation rate have no effect on the unemployment rate. The long-run Phillips curve is vertical, thereby showing that in the long run, ANY inflation rate can occur but in the long run the unemployment rate will equal the natural unemployment rate.
Topic: The Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

18) Distinguish between the short-run and long-run Phillips curves.
Answer: The long-run Phillips curve shows the relationship between inflation and unemployment when the unemployment rate equals the natural rate and the inflation rate equals the expected inflation rate. There is no long-run tradeoff between inflation and unemployment. The short-run Phillips curve, however, shows the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate do not change. The short-run Phillips curve is downward sloping, so that it shows a tradeoff between inflation and unemployment.
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

19) Explain how the short-run and long-run Phillips curves are related.
Answer: The short-run Phillips curve is the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate remain constant. The long-run Phillips curve is the relationship between the inflation rate and the unemployment rate when the economy is at full employment. The short-run Phillips curve is downward sloping, indicating that if the expected inflation rate and natural unemployment rate do not change, a higher inflation rate decreases the unemployment rate. The long-run Phillips curve is a vertical line illustrating that in the long run, the economy at full employment can have any inflation rate. The short-run Phillips curve intersects the long-run Phillips curve at the expected inflation rate. A change in the expected inflation rate shifts the short-run Phillips curve but has no effect on the long-run Phillips curve. An increase in the natural unemployment rate shifts both the short-run and the long-run Phillips curve.
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

20) When the expected inflation rate changes, what happens to the short-run Phillips curve? To the long-run Phillips curve?
Answer: When the expected inflation rate changes, the short-run Phillips curve shifts but the long-run Phillips curve does not shift. In particular, if the expected inflation rate increases, the short-run Phillips curve shifts upward and if the expected inflation rate decreases, the short-run Phillips curve shifts downward.
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

21) When the natural unemployment rate changes, what happens to the short-run Phillips curve? To the long-run Phillips curve?
Answer: When the natural unemployment rate changes, both the short-run Phillips curve and the long-run Phillips curve shift. If the natural unemployment rate increases, both Phillips curves shift rightward; if the natural unemployment rate decreases, both Phillips curves shift leftward.
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

22) Using the Phillips curves, what are the short-run and long-run effects of a decrease in the inflation rate?
Answer: In the short run, there is first a downward movement along the short-run Phillips curve as the inflation rate falls and the unemployment rate increases. In the long run, however, the expected inflation rate falls and the short-run Phillips curve shifts downward. Therefore in the long run the inflation rate remains low and the unemployment rate returns to the natural unemployment rate.
Topic: The Short-Run and Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

23) What is the factor that leads to business cycles in the Keynesian cycle theory?
Answer: The impulse in the Keynesian theory is changes in firms' expectations about future sales and profits, which changes investment. Keynes referred to these expectations as "animal spirits."
Topic: Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

24) What is the factor that leads to business cycles in the monetarist cycle theory?
Answer: The factor leading to business cycles in the monetarist theory is changes in the growth rate of the quantity of money.
Topic: Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

25) Compare and contrast the Keynesian and Monetarist business cycle theories.
Answer: Both theories are centered about changes in aggregate demand as the central cause of the business cycle. Keynesian's use the concept of 'animal spirits' and the inability to forecast the future as the factor that leads to changes in investment. Monetarists assert that changes in the growth rate of the quantity of money is the factor that leads to business cycles. As for the adjustment following the initial shock of a change in the level of investment, both theories envision a multiplier effect. This effect causes a greater change in aggregate demand (and hence real GDP) than would occur strictly as a result of the initial change in real GDP. Both theories also believe that sticky wages limit the ability of the money wage rate to adjust to changes in aggregate demand.
Topic: Keynesian and Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

26) What is the factor that leads to business cycles in the new classical cycle theory?
Answer: The factor leading to business cycles in the new classical theory is unexpected changes in aggregate demand.
Topic: New Classical Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

27) What is the factor that leads to business cycles in the new Keynesian cycle theory?
Answer: The MAJOR factor in the new Keynesian cycle theory is unexpected changes in aggregate demand, but expected changes in aggregate demand also play a role in creating business cycles.
Topic: New Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

28) What is the impulse in the real business cycle theory of the business cycle?
Answer: The impulse in the real business cycle theory is technological changes that affect the growth rate of productivity.
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

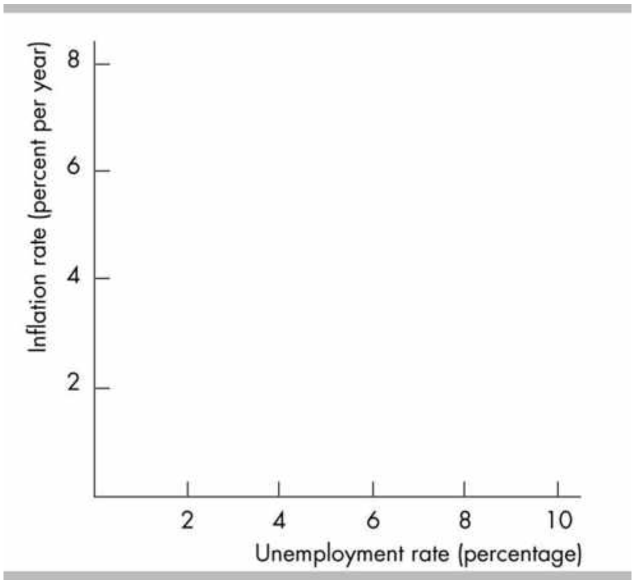
29) What is the impulse that leads to business cycle in the real business cycle, RBC, theory?
Answer: The real business cycle theory focuses on changes in the growth rate of productivity as the main source of economic fluctuations. Furthermore, the RBC theory views these changes as random and mainly as a result of changes in the rate of technological change. It asserts that most of the time technological change is steady, allowing for productivity to grow at a moderate pace. Occasionally productivity growth speeds up or slows down. If it speeds up, an expansion can be triggered while if it slows down a recession can result.
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

30) What is the intertemporal substitution effect and what role does it play in the real business cycle model?
Answer: The intertemporal substitution effect is the idea that people choose when they will work by comparing the real wage rate they receive this year to the real wage rate next year, taking into account the real interest rate. Basically, employees compare how much they would have earned if they worked this year (and received the real wage rate) and then saved this amount (and thereby increased the amount by the real interest rate) to the real interest rate they would earn by working next year. This effect plays a key role in the real business cycle theory because it means that the supply of labor changes when the real interest rate changes. For instance, as the economy heads into a recession with investment demand decreasing, the decrease in investment demand lowers the real interest rate, so the intertemporal substitution effect decreases the supply of labor and hence employment. As a result, potential GDP decreases.
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

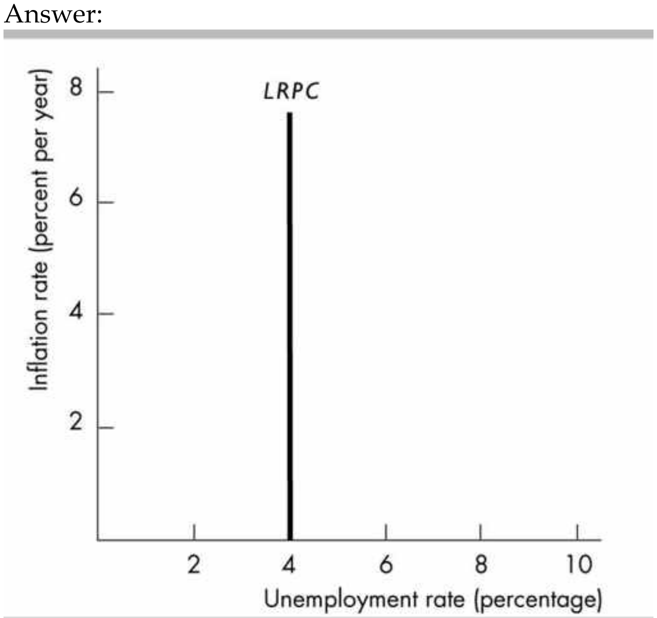
31) What are criticisms of the real business cycle theory?
Answer: Four criticisms of the real business cycle theory are frequently made. First is the criticism that money wage rates are sticky, whereas the real business cycle theory assumes they are flexible. Second is the assertion that intertemporal substitution is too weak to account for large fluctuations in employment. Third is the criticism that technology shocks are implausible as an impulse that causes a business cycle. Fourth is the comment is that productivity shocks, as measured, are correlated with factors that change aggregate demand and so are the RESULT of the business cycle not a CAUSE of the business cycle.
Topic: Criticisms of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

32) How do defenders of the real business cycle theory, (RBC theory) respond to critics of the theory?
Answer: The defenders of the real business cycle theory state that the theory works because it accurately describes the real-life experiences of both growth and the cyclical nature of growth. The theory is also consistent with much microeconomic evidence about labor supply, labor demand and investment demand decisions. They believe that although the quantity of money is correlated with real GDP, real GDP changes cause the changes in the quantity of money. Lastly, RBC theory proponents assert that the theory is important because it points out that business cycles might be a normal state of affairs, which suggests that government attempts to dampen them are futile.
Topic: Defenses of Real Business Cycle Theory
Skill: Conceptual
Status: Old
AACSB: Written and oral communication

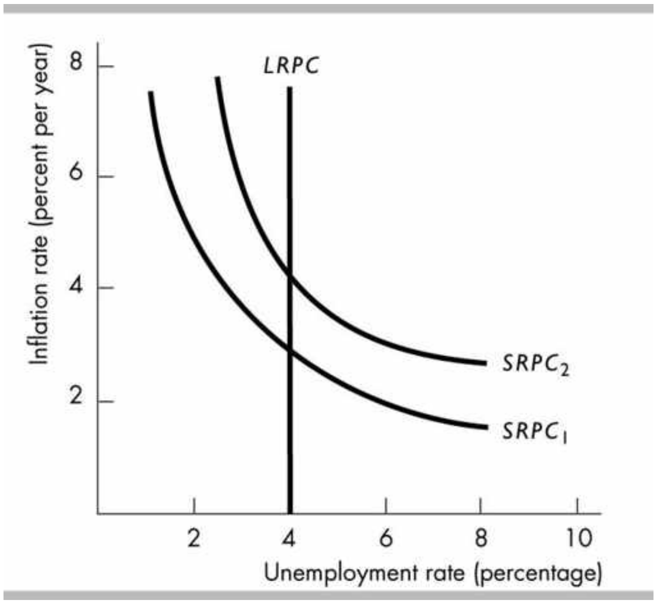
7 Numeric and Graphing Questions



1) Suppose the natural unemployment rate is 4 percent and the expected inflation rate is 6 percent. In the above figure, illustrate the long-run Phillips curve. What does the long-run Phillips curve reveal about the long-run tradeoff between inflation and unemployment?
Answer:



The long-run Phillips curve is illustrated in the above figure. It is vertical at the natural unemployment rate. The fact that the long-run Phillips curve is vertical means that in the long run there is no tradeoff between inflation and unemployment. In other words, in the long run higher inflation does not decrease unemployment nor does low inflation increase unemployment.
Topic: The Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking



2) In the above figure, what factor might have led to the shift in the short-run Phillips curve from $SRPC_1$ to $SRPC_2$?

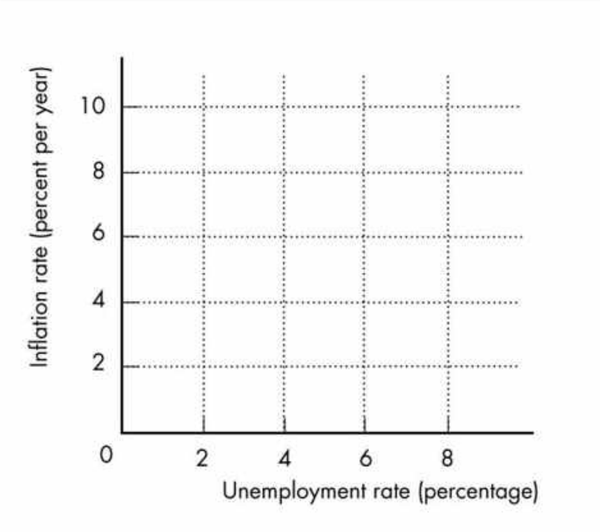
Answer: The long-run Phillips curve did not shift. Therefore the factor that shifted the short-run Phillips curve was an increase in the expected inflation rate.

Topic: The Short-Run and Long-Run Phillips Curve

Skill: Analytical

Status: Old

AACSB: Analytical thinking



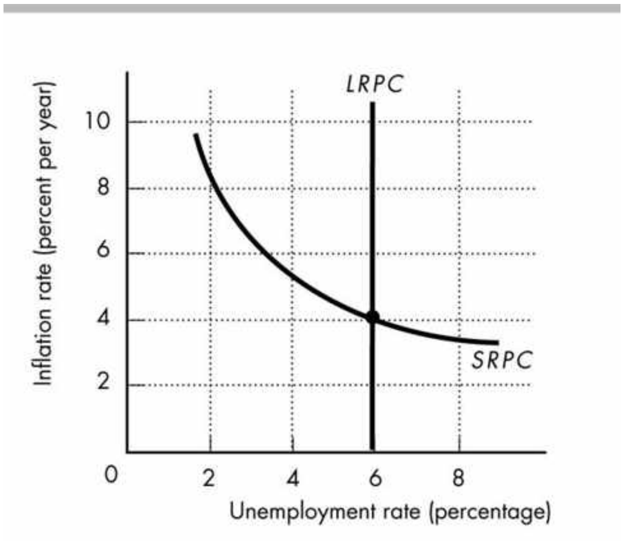
3) In the figure above, draw a short-run Phillips curve and a long-run Phillips curve if the expected inflation rate is 4 percent and the natural unemployment rate is 6 percent. Explain how the two change in the short run if:

a) slower growth in aggregate demand causes a recession.

b) the inflation rate increases.

c) the natural unemployment rate increases.

Answer:



The figure with the Phillips curves is above.

a) There is a downward movement along the short-run Phillips curve.

b) There is an upward movement along the short-run Phillips curve.

c) There is a rightward shift of both the long-run and short-run Phillips curves.

Topic: The Short-Run and Long-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Analytical thinking

8 True or False

1) Inflation describes the event of increasing output and rising prices.
Answer: FALSE
Topic: Inflation and the Price Level
Skill: Recognition
Status: Old
AACSB: Reflective thinking

2) A one-time increase in aggregate demand creates inflation.
Answer: FALSE
Topic: Inflation and the Price Level
Skill: Recognition
Status: Old
AACSB: Reflective thinking

3) Increases in the quantity of money can create demand-pull inflation.
Answer: TRUE
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

4) For a persistent demand-pull inflation to occur, government expenditure must persistently increase.
Answer: FALSE
Topic: A Demand-Pull Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

5) The early 1990s were the last period of substantial demand-pull inflation in the U.S.
Answer: FALSE
Topic: Demand-Pull Inflation in the United States
Skill: Recognition
Status: Old
AACSB: Reflective thinking

6) Increases in government expenditure can create cost-push inflation.
Answer: FALSE
Topic: Cost-Push Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

7) Increases in the prices of raw materials can create cost-push inflation.
Answer: TRUE
Topic: Cost-Push Inflation
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

8) For a persistent cost-push inflation to occur, the Fed must persistently increase the quantity of money.
Answer: TRUE
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

9) Stagflation occurs when the *SAS* curve shifts leftward.
Answer: TRUE
Topic: A Cost-Push Inflation Process
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

10) The Phillips curve describes the relationship between real GDP and inflation.
Answer: FALSE
Topic: Inflation and Unemployment: The Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

11) The short-run Phillips curve is vertical at the natural unemployment rate.
Answer: FALSE
Topic: The Short-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

12) An increase in the expected inflation rate leads to a movement upward along the short-run Phillips curve.
Answer: FALSE
Topic: The Short-Run Phillips Curve
Skill: Analytical
Status: Old
AACSB: Reflective thinking

13) The long-run Phillips curve slopes downward.
Answer: FALSE
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

14) The long-run Phillips curve is vertical at the natural unemployment rate.
Answer: TRUE
Topic: The Long-Run Phillips Curve
Skill: Recognition
Status: Old
AACSB: Reflective thinking

15) The short-run Phillips curve intersects the long-run Phillips curve at the actual inflation rate.
Answer: FALSE
Topic: The Short-Run Phillips Curve and the Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

16) The short-run Phillips curve intersects the long-run Phillips curve at the expected inflation rate.
Answer: TRUE
Topic: The Short-Run Phillips Curve and the Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

17) An increase in the natural unemployment rate shifts <u>BOTH</u> the long-run Phillips curve <u>AND</u> the short-run Phillips curve rightward.
Answer: TRUE
Topic: The Short-Run Phillips Curve and the Long-Run Phillips Curve
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

18) Monetarists believe in changes in animal spirits are the factor that leads to business cycles.
Answer: FALSE
Topic: Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

19) The monetarist theory of the business cycle views fluctuations in the growth rate of the quantity of money as the main source of economic fluctuations.
Answer: TRUE
Topic: Monetarist Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

20) The new classical cycle theory views anticipated fluctuations in aggregate demand as the main source of business cycle economic fluctuations.
Answer: FALSE
Topic: New Classical Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

21) The new Keynesian cycle theory views only anticipated changes in aggregate demand as the source of business cycle economic fluctuations.
Answer: FALSE
Topic: New Keynesian Theory
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

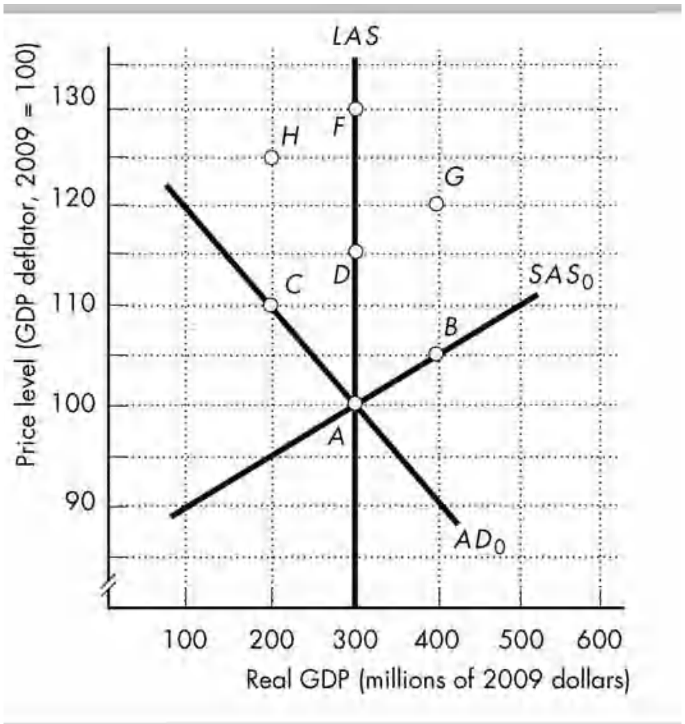
22) The real business cycle theory views fluctuations in the quantity of money as the main source of business cycles.
Answer: FALSE
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

23) The real business cycle theory views fluctuations in productivity as the main source of business cycles.
Answer: TRUE
Topic: RBC Impulse
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

24) The intertemporal substitution effect is the factor that creates business cycles in the Keynesian theory of the business cycle.
Answer: FALSE
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

25) According to the real business cycle theory, a decrease in the real interest rate today increases current labor supply.
Answer: FALSE
Topic: RBC Mechanism
Skill: Conceptual
Status: Old
AACSB: Reflective thinking

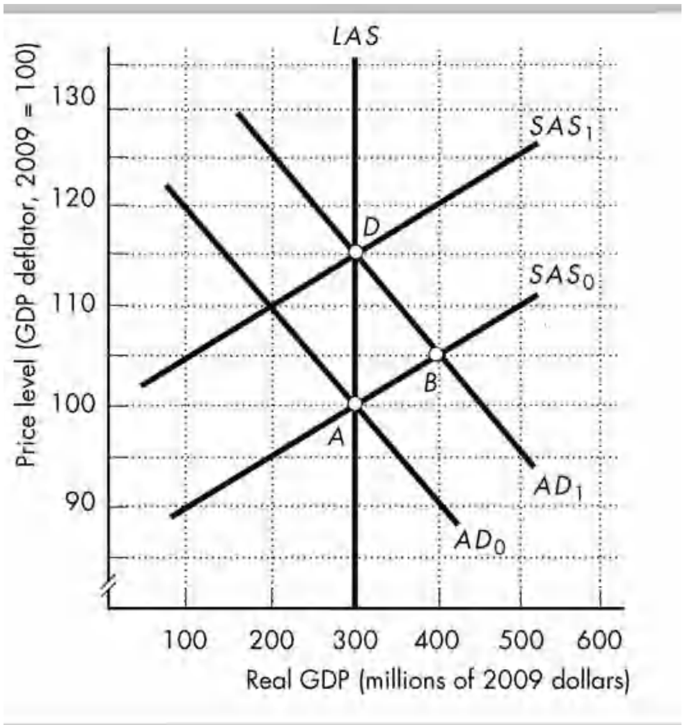
9 Extended Problems



1) The figure above shows the initial aggregate demand curve, AD_0, the initial short-run aggregate supply curve, SAS_0, and the long-run aggregate supply curve, LAS. The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Then, the government increases its expenditure on goods and services. Draw the new aggregate demand and short-run aggregate supply curves in the figure to show the effects of this event on Atlantia's real GDP and price level.

a) What happens to Atlantia's potential GDP?
b) In the short run, what happens to aggregate supply and aggregate demand?
c) What are the new short-run equilibrium real GDP and price level?
d) In the long run, what happens to the short-run aggregate supply and aggregate demand?
e) What are the new long-run equilibrium real GDP and price level?

Answer:
a) Atlantia's potential GDP is not affected. Potential GDP depends on the economy's factors of production and available technology, not on aggregate spending.



b) See the figure above. The increase in government expenditure increases aggregate demand. The aggregate demand curve shifts from AD_0 to AD_1. Because there is no change in potential GDP and no change in the money wage rate, short run aggregate supply is not affected. The short-run aggregate supply curve remains at SAS_0.

c) In the short run the economy is at point *B*, where real GDP is $400 million and the price level is 105.

d) Because at point *B* real GDP is above potential GDP, unemployment is less than the natural rate so the tight conditions in the labor market means that the money wage rate begins to rise. As it does, short-run aggregate supply decreases. The short-run aggregate supply curve shifts from SAS_0 to SAS_1. Because nothing further affects aggregate demand, the aggregate demand curve remains at AD_1.

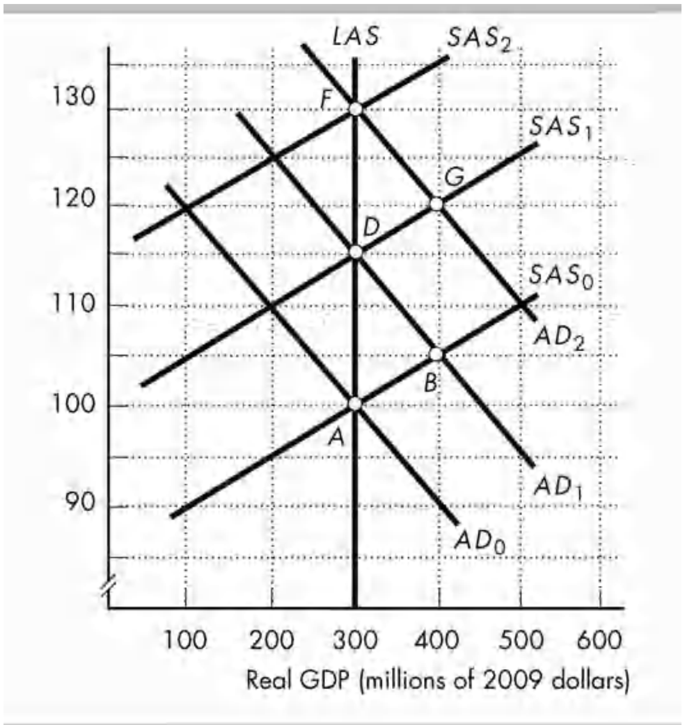
e) In the long run the economy is at point *D*, where real GDP is $300 million and the price level is 115.

Topic: Demand-Pull Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

2) The figure above shows the initial aggregate demand curve, AD_0, the initial short-run aggregate supply curve, SAS_0, and the long-run aggregate supply curve, LAS. The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Atlantia's Central Bank then increases the quantity of money year after year. Draw the necessary curves in the figure to show the effects of this on Atlantia's real GDP and price level.

a) What happens to Atlantia's potential GDP?
b) In the short run, what happens to aggregate supply and aggregate demand?
c) What are the new short-run equilibrium real GDP and price level?
d) In the long run, what happens to aggregate supply and aggregate demand?
e) In the long run, what process is unfolding?

Answer:
a) Atlantia's potential GDP is not affected. Potential GDP depends on the economy's factors of production and available technology, not on monetary factors.



b) See the figure above. The increase in the quantity of money lowers the interest rate and increases aggregate demand. The aggregate demand curve shifts rightward from AD_0 to AD_1. Because there is no change in potential GDP and no change in the money wage rate, the short-run aggregate supply is not affected. The short-run aggregate supply curve remains at SAS_0.
c) In the short run the economy is at point *B*, where real GDP is $400 million and the price level is 105.
d) Because at point *B* real GDP exceeds potential GDP, unemployment is less than the natural rate so the tight conditions in the labor market means that the money wage rate begins to rise. As it does, short-run aggregate supply decreases. The short-run aggregate supply curve shifts from SAS_0 to SAS_1, bringing the economy to point *D*. But the Central Bank increases the quantity of money again, and aggregate demand continues to increase. The aggregate demand curve shifts rightward to AD_2. The economy moves to point *G*, so that the price level rises still more to 120 and real GDP again exceeds potential GDP at $400 million. The money wage rate rises once again, further decreasing short-run aggregate supply. The short-run aggregate supply curve shifts from SAS_1 to SAS_2, bringing the economy to point *F*. As the quantity of money continues to grow, aggregate demand continues to increase and short-run aggregate supply continues to decrease.
e) In the long run, the price level rises continuously as the economy moves from point *A* to point *B* to point *D* to point *G* to point *F* and so on. An ongoing demand-pull inflation process is the result.
Topic: Demand-Pull Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

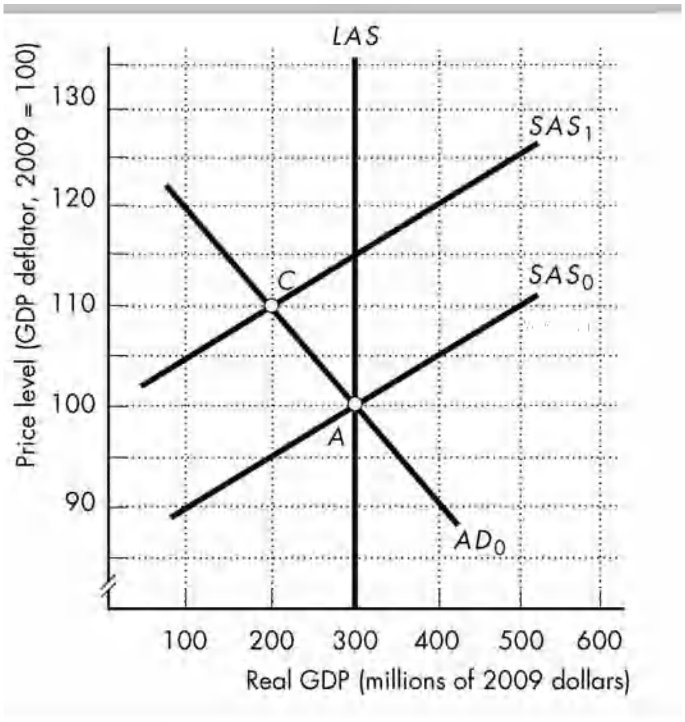
3) The figure above shows the initial aggregate demand curve, AD_0, the initial short-run aggregate supply curve, SAS_0, and the long-run aggregate supply curve, LAS. The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Then, Atlantia's oil producers form a price-fixing organization and increase the price of oil. Suppose that potential GDP does not change and that Atlantia's Central Bank takes no action. Draw the new aggregate demand and short-run aggregate supply curves in the figure to show the effects of this event on Atlantia's real GDP and price level.

a) What happens to aggregate supply and aggregate demand?

b) What are the new equilibrium real GDP and price level?

c) Will the rise in the price of oil lead to inflation in Atlantia? Why or why not?

Answer:



a) See the figure above. The increase in the price of oil raises the cost of production and decreases short-run aggregate supply. The short-run aggregate supply curve shifts leftward from SAS_0 to SAS_1. Aggregate demand is not affected, so the aggregate demand curve remains at AD_0.

b) In the short run the economy moves to point C, where real GDP is $200 million and the price level is 110.

c) The rise in the price of oil results in a one-time rise in the price level, but not ongoing inflation. A one-time rise in the price level can only be converted into inflation if it is accompanied by growth in the quantity of money.

Topic: Cost-Push Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking

4) The figure above shows the initial aggregate demand curve, AD_0, the initial short-run aggregate supply curve, SAS_0, and the long-run aggregate supply curve, LAS. The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Then, Atlantia's oil producers form a price-fixing organization and increase the price of oil. Suppose that potential GDP does not change and that Atlantia's Central Bank responds by increasing the quantity of money. Draw necessary curves in the figure to show the effects of this on Atlantia's real GDP and price level.

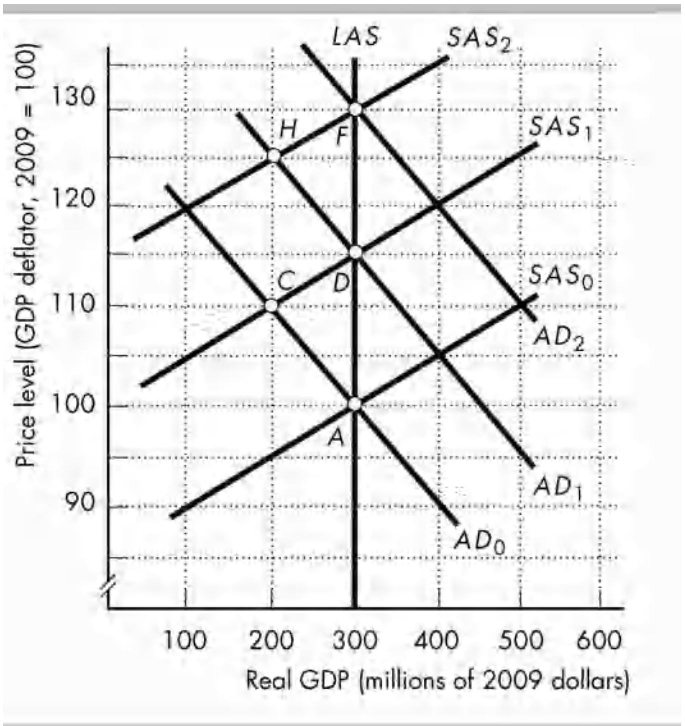
a) In the short run, what happens to aggregate supply and aggregate demand?

b) What are the new short-run equilibrium real GDP and price level?

c) In the long run, if Atlantia's continue to hike the price of oil and the Central Bank continues to increase the quantity of money, what happens to aggregate supply and aggregate demand?

d) If Atlantia's oil producers continue to hike the price of oil and Atlantia's Central Bank responds by increasing the quantity of money, what process unfolds?

Answer:



a) See the figure above. The increased price of oil raises the cost of production and decreases short-run aggregate supply. The short-run aggregate supply curve shifts from SAS_0 to SAS_1. As the Central Bank increases the quantity of money, the interest rate falls, and aggregate demand increases. The aggregate demand curve rightward shifts from AD_0 to AD_1.

b) In the short run, the economy moves to point *D*, where real GDP is $300 million and the price level is 115.

c) As the oil producers respond to the higher price level by raising the price of oil, short-run aggregate supply decreases again and the short-run aggregate supply curve shifts leftward again, from SAS_1 to SAS_2. As the Central Bank increases the quantity of money again, aggregate demand increases once more and the aggregate demand curve shifts rightward from AD_1 to AD_2. The economy moves to point *F*, where the price level is even higher. This invites another oil price hike that will call forth yet a further increase in the quantity of money. So short-run aggregate supply continues to decrease and aggregate demand continues to increase.

d) If Atlantia's oil producers continue to hike the price of oil and Atlantia's central bank continues to increase the quantity of money, a cost-push inflation process unfolds. The price level rises continuously as the economy moves from point *A* to point *C* to point *D* to point *H* to point *F* and so on.

Topic: Cost-Push Inflation
Skill: Analytical
Status: Old
AACSB: Analytical thinking