

Old Exam Questions  
MEBS course on Monetary Economics

John J. Seater

1. Turkey recently reduced the growth rate of its nominal money supply. Draw graphs showing the time paths of the

- money growth rate
- level of the nominal money supply
- inflation rate
- price level
- nominal interest rate
- real money supply

before the change and then after it. Assume no one expected the reduction before it happened and that everyone believes the reduction in money growth is permanent. ***Explain the economic reasoning behind your graphs.***

2. Suppose the exchange rate between two countries A and B floats freely. Country A has a real rate of economic growth of 3% a year and a money growth rate of 10% a year. Country B has a real rate of economic growth of 2% a year and a money growth rate of 2% a year. Trade is completely free, there are no transportation costs, and there are no capital market imperfections.

Explain:

- (1) the behavior over time of the exchange rate between the currencies for countries A and B
- (2) the relation between the nominal interest rates countries A and B.

3. The money growth rate  $\mu$ , the inflation rate  $\pi$ , and the real money supply  $M/P$  for a few years in Bolivia were:

<u>Year</u>	<u><math>\mu</math></u>	<u><math>\pi</math></u>	<u><math>M/P</math></u>
1979	22%	20%	9533
1980	28%	47%	8260
1981	23%	32%	7671
1982	103%	124%	6973

1983

239%

276%

6295

We see immediately that

- (a)  $\mu$  and  $\pi$  have upward trends over the five year period
- (b) M/P has a downward trend
- (c)  $\pi$  has a general tendency to be larger than  $\mu$

Explain the economic relationships that cause the observed behavior among these  $\mu$ ,  $\pi$ , and M/P.

4. Unexpected changes in the money supply can have different effects on the economy in the short run (when the actual price level  $P$  does not necessarily equal the expected or perceived price level  $P^e$ ) and in the long run (when  $P = P^e$ ). Suppose the government unexpectedly reduces the money supply. Explain **both** the short-run effects **and** the long-run effects of such a policy change on

- (i) the level of output
- (ii) the price level
- (iii) the interest rate
- (iv) the level of employment
- (v) the real wage
- (vi) the nominal wage

[So **explain 12 things**: (i) through (vi) for the short run and (i) through (vi) for the long run.]

5. Suppose the government unexpectedly increases the rate of growth of the nominal money supply and maintains the higher growth rate forever. Explain how output and employment evolve over time in response to this policy change. Be sure to include an explanation of what happens in both the short run and the long run.

6. *Explain* whether the following statements are true or false:

A. A increase of one percentage point in the growth rate of the nominal money supply is accompanied by approximately an increase of one percentage point in the inflation rate.

B. It is possible for the actual real interest rate (not the expected real interest rate) to be negative.

C. An increase in the monetary growth rate that creates inflation requires people to work additional hours if they want to keep their real consumption from falling.