ECON 1150 Honors Macroeconomics Quiz #3 Answers Fall 2013 Name______________________

Forward looking (class, lecture notes LDQ Assignments / Back looking (Text, tutors and Blackboard quizzes)

Post 2008 CSM/Keynesian Macroeconomics (PK-Minsky) / Pre-2009 Classical Macro or Neo-Keynesian (Mankiw)
I. Multiple choice and short answer: *you can use the blanks in the question to gather your answer, but please also gather your answers to the left of each question before your turn in the quiz. No acronyms: ask in class if needed.*

_D _DACB 1. Which of the following is what economists mean by "money." Next list (on 2nd ling) list these assets from most to least liquid. (a) stocks & bonds (b) real estate (c) cars (d) cash & MM mutual funds

_D_A_ G _F/H 1A. In normal times the Federal Reserve uses mainly __ to target the __but since 2009 the Fed has targeted ____ and unofficially the __ & ___ a) Federal Funds (FF) Rate b) Reserves requirements c) the Discount rate d) Open market operations e) Short term interest rates f) inflation rate g) longer term interest rates h) Unemployment

[2009]_D_ [year] 2. Since the FF rate hit the floor in ____ , the Federal Reserve targeting, formally & informally, everything except the a) long term/future interest rates b) inflation rate c) unemployment rate d) the M_S (M1 or M2)

D 3. The quantity of money equation links the money supply to prices by assuming the __ of money is constant. a) real GDP b) the price level c) the inflation rate d) velocity e) interest rates f) wages g) money

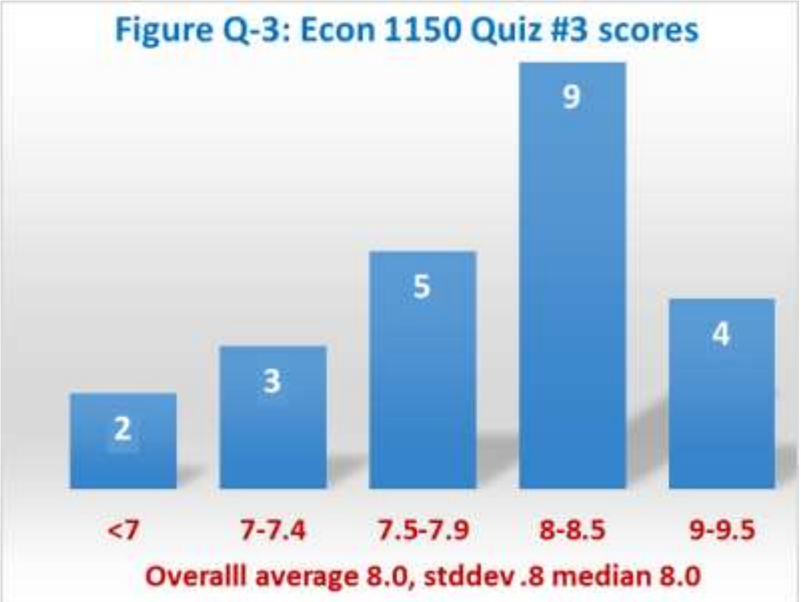
_C_E_T_ 4. The Fisher effect links __perfectly to nominal _ thereby protecting bondholders against inflation (T/F).
(if the Fisher effect works, it does protect bond holders unless they are wrong about inflation)
Money F 5. By definition inflation reduces the value of ___ in the long run, but not purchasing power of __ (#3 choices)

F/E 6. In the short run, inflation can reduce real __ and real ___ thereby raising profits for business (#3 choices).

_10__1/R_ 7 If the required reserve ratio is 10% but banks do not lend out all the funds they can, the money multiplier is less than ___ (first a number, then the formula in the next blank if possible you can).

zero(FIB) 8. Though the Fed still tracks M1 and M2, it no longer targets the money supply in part because the overnight FF rate is virtually____ (FIB, a number).
_F_ 9. (T/F) The Federal Reserve Chair and the board of the FOMC are not democratically elected and are largely unaccountable to congress (hence W. Greider's 1989 book titled "*Secrets of the Temple*…").

_A_E_C_ [2013] [year] 10. Older Europeans and Americans are haunted by different demons, the memory of __in Vienna and Berlin after WWI leads European to fear ___where as many of your grandparents remember the __ U.S. immortalized in WJB's "cross of gold" speech just before our Federal Reserve was set up in __(year). (a) Hyperinflation (b) disinflation (c) deflation (d) unemployment rate e) inflation
€
_D_11. (#10 choices) The Dow rose after the last BLS employment report in part because the Fed has an __ target



II. EC Short Answer Questions: Answer one on the back if you have time, use these questions to review for midterm

1. Is inflation theft, legally or morally? (a) Who loses when inflation is unexpectedly high, the rich or the poor? (b) What can middle class households do to protect themselves against inflation? (c) How is Ben Bernanke's Fed Reserve making it easier to do this right now? (hint: what the two FMs sell) Is this policy working? Is Ben happy? D) Do our policy makers seem to think we can trade inflation for unemployment? Do you agree with them? Explain.

2. According to Bagehot, 1858 to fulfill their LOLR role during crises, Central Banks should lend freely at penalty rates… (a) Why? Which CB followed this maxim at first in 2008-2009, the Fed or the ECB? Which CB changed course especially a new head took over in the year of the Dragon? (c) Did the ECB or the Federal Reserve now lend to banks at "penalty rates." If not why not? Is this going to create moral hazard problems going forward? The ECB is making 3 year Euro loans at 1% interest to banks that do what? Could this be a penalty rate in disguise?

3. Current and former UCB Professors Christine Romer and Janet Yellen Professors are a little disappointed with Ben Bernanke because despite his nickname "Helicopter Ben" he has not been as aggressive as he might have been with monetary policy. (a) List the pros and cons of a 2% vs, 4% inflation target (perhaps 3% is a good compromise). (b) What is U.S. inflation now? Are we on target, or drifting away from Bernanke's unofficial inflation target? (c) what can be done to raise the U.S. inflation rate? What are the risks of higher inflation?

Comments on inflation as theft exchange: Paul Krugman is always saying Economics is not a morality play, it is a forward looking policy oriented. Recessions are not (should not) be seen as punishment for those who caused the crisis. The objective of macroeconomic policy is to minimize pain (for everyone, guilty or not). Of course we need to punish firms and people who intentionally broke the rules (insider trading, Bernie Madoff) but this will not stop the next boom and bust or make the next crisis shorter. Warren Buffet said "when the tied goes out you can see who is not wearing a swimsuit" but did people not wearing clothes cause the tide to go out? Not really (which I think is his point). We have never had capitalism or banks w/o financial crisis and runs, yet most believe we need some sort of capitalism and banking system to sustain recent growth in living standards (even China, a communist country, has banks and credit and a Central bank, and it certainly promotes capitalism, for better or works…. See the Hans Rosling video on the rise of Asia).

Are we out of the woods yet? Not quite, the great Depression started with the financial crisis of 1929, it was not until 1939 (WWII) really that the U.S. economy emerged from ten years of low growth and deflation. Similarly Japan's crash hit in 1990-91, it has still not resumed normal growth (though it is trying with AbeEconomics, basically Bernanke and Krugman's dictum of inflation no matter what…. Check the Yen, is it working….?)

[Larry Summers](#) on the crisis and fixing JFK (or Sandy repairs), recall opportunity cost and crowding out.

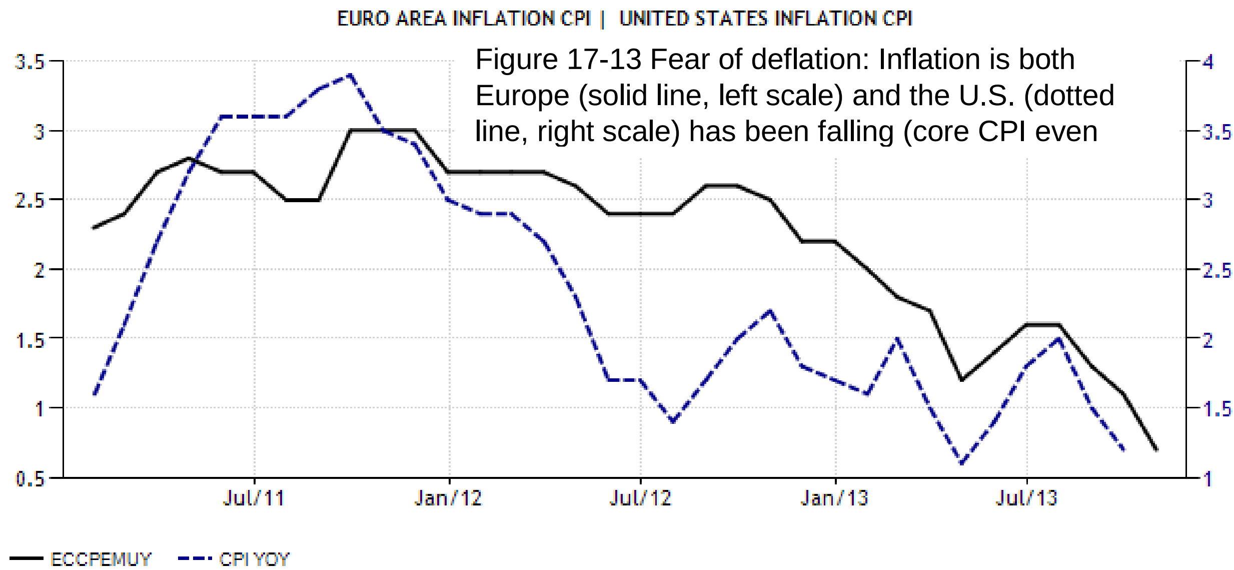


Figure 17-13 Fear of deflation: Inflation is both Europe (solid line, left scale) and the U.S. (dotted line, right scale) has been falling (core CPI even

Source: Trading Economies.com