**JHU ECON 602:**

**MACROECONOMIC THEORY AND POLICY (Fall 2022)**

**Practice Quiz 2**

1. **True, False or Uncertain**. State whether the following statements are True, False or Uncertain. For statements that are False, correct the error or errors (note that there may be more than one error and for full credit you have to correct all of them). For statements that are Uncertain, explain why that is the case.
2. Okun’s Law states that a reduction in the cyclical unemployment rate leads to a cyclical increase in output because when more people are employed there is more production.
3. Global average incomes have roughly tripled since 1960, but global output has remained stagnant due to the decline of manufacturing.
4. The provision of unemployment insurance raises the natural rate of unemployment by raising the job separation rate; the trend rate of inflation also rises as unemployed people have much more money to spend when they receive unemployment insurance.
5. If the real exchange rate rises, domestic goods become more expensive relative to foreign goods, net exports rise, and the current account goes into surplus as countries have to pay more for domestic goods.
6. The U.S. nominal interest rate has declined considerably since the early 1980s, but because expected inflation has declined as well, the real rate has declined much less than the nominal rate.
7. The debt-to-GDP ratios of many countries declined in decades after World War II as a result of haircuts and primary fiscal surpluses.
8. The labor force participation rate is the ratio of the labor force to the number of people unemployed.

1. The Taylor Rule states that if inflation increases above its target (holding GDP gap constant), monetary policy should be eased by lowering the real policy interest rate below the neutral interest rate to boost imports and government spending.
2. During the 2000s, the region with the weakest income growth was North America and the one with the fastest growth was Sub-Saharan Africa, suggesting that poor countries have caught up with the rich countries.
3. Output gap is the difference between real GDP and the long-run trend in inflation.
4. The natural rate of unemployment in the United States about 10 percent, but it generally falls to about 8 percent during a recession.
5. Stabilization policy refers to policy actions aimed at raising the trend rate of economic growth.
6. The current account deficits in the United States since 1900 are mainly driven by wars and recessions.
7. In the United States, real GDP has generally fluctuated between -1 percent and +1 percent over the course of the business cycle, but the unemployment rate has gone up twice as much, which is consistent with Okun’s Law.
8. The quantity theory predicts a one-for-one relationship in the short run between changes in the money growth rate and changes in the inflation rate.
9. U.S. income per capita is about $62,500, which is 25% of the world average.
10. The federal funds ratewent from 2.5% in July 2007 to 10% in December 2008 but could not go higher because of limits on loan-to-value ratios.
11. GDP is the sum of incomes in the economy during a given period.
12. The unemployment rate is the percent of the population who do not have a job and are not looking for one because they are discouraged.
13. The participation rate is the ratio of the labor force to the unemployment rate.
14. The inflation rate is the rate at which the price level increases.
15. The standard composition of GDP is consumption plus investment plus government spending plus net exports.
16. An increase in the interest rate raises the demand for money, as people work harder to take advantage of the higher interest rates.
17. In an expansionary open market operation, the central bank expands the supply of money by selling bonds.
18. Risk premia are determined by the probability of default and the degree of risk aversion of bond holders.
19. In the United States, the average duration of unemployment—the length of time people spend unemployed—is about 2 months.
20. The Phillips Curve is the negative relationship between the inflation rate and the unemployment rate.
21. In the United States, expectations of inflation that became de-anchored during the 1970s and 1980s became re-anchored in the mid-1990s because central banks cut policy interest rates to the zero lower bound.
22. Discount bonds are bonds that promise a single payment at maturity called the face value, while coupon bonds are bonds that promise multiple payments before maturity but no payment at maturity.
23. The real exchange rate is the price of domestic currency in terms of foreign goods, whereas the nominal exchange rate is the price of the foreign currency in terms of domestic goods.
24. **Short Answers:**
25. Describe the relationship between incomes and unemployment in the short run and in the long run.
26. What factors influence the evolution of the debt-to-GDP ratio?
27. What are the pros and cons of adoption of the euro?
28. On what factors do consumption and investment depend, and why?
29. What is the most interesting thing you have learnt in this course so far and why?