Macroeconomics 1
Problem set 8

Tick the correct alternatives (more than one may be correct) or write your answer in the space provided. Unless otherwise stated, the notation and behavioural assumptions are the same as in the lectures and textbook.

1. Agents revise their expectations about the inflation rate up. How does this affect the equilibrium levels of: the real interest rate, the nominal interest rate, output and the current price level
   a) in the short run?
   b) in the long run?

2. Assume that the investment function takes the form $I = a - br + dY$, with d satisfying $1 - c_1 > d > 0$. If consumers want to save more
   a) The short run equilibrium level of output increases. True/false/uncertain.
   b) The short run equilibrium interest rate will fall. True/false/uncertain.
   c) The short run equilibrium level of investment increases. True/false/uncertain.
   d) The short run equilibrium price level will increase. True/false/uncertain.

3. You are an advisor to the IMF. Country X needs to reduce aggregate investment, but at the same time wants to keep output at its full employment level both in the short and long run. Which policy mix would you suggest?
   a) Expansionary fiscal and monetary policy.
   b) Contractionary fiscal policy and expansionary monetary policy.
   c) None of the above.

4. Suppose that private agents' marginal propensity to hold currency c equals zero. Banking laws require banks to keep 0.25£ of reserves for every 1£ of loans. What is the value of the money supply multiplier in this economy? __________ If the supply of base money is £100, what is the supply of M_1? __________In equilibrium, who holds notes and coins in this economy? Banks/Private agents/Both.