EXERCISE FOR MONEY AND BANKING

1. The Central Bank decides to stimulate the economy by driving down the real interest rate. Months pass, however, before new factories and houses begin to be built in response. This is an example of _____________.

2. If the nominal interest rate on saving is 12 percent and the expected inflation rate is 6 percent, what is the percentage reduction in real interest income resulting from a tax of 25 percent?

3. The money supply is growing at 3 percent per year, real output is growing at 2 percent per year, velocity is constant and the nominal interest rate is 7 percent. What is the inflation rate?

4. Market interest rates currently stand at 6 percent and the velocity of money is 6. If market interest rates rise, everything else being equal, velocity will decrease/increase/remain unchanged/be undetermined. Circle only one and explain at most with two sentences.

5. The aggregate demand curve and the demand curve for individual goods are negatively sloped for the same reasons. (True/False) Explain!

6. After years of spending more than their incomes, people decide to reduce their debt, thus increasing saving. What effect does this action have on the economy? If you are a new Keynesian economist in charge of monetary policy, what should you do?

7. Suppose that the economy goes through a recession in which many people are unable to repay their credit card debt. Banks lose a lot of money and decide to curtail credit card issuance sharply. Is this action likely to be expansionary or contractionary? Why?

8. As a result of a flood that hits Akdeniz region, the prices of fruits and vegetables increase. What effect will this increase have on aggregate output, price level and interest rates?

9. Some economic historians have argued that one source of discontent among farmers in the U.S. during late 19th century was that they were debtors at a time of falling price. Other economic historians have argued that deflation should not have been a problem for farmers because it went on several decades. Evaluate these views, being sure to discuss under what circumstances debtors are hurt by deflation.

10. Suppose that government seriously tried to balance its budget by raising corporate taxes. According to new classical view, what effect would this action have on output and the price level? How could monetary policy be used to offset this effect?

11. Is an investment tax credit inflationary in the short run and in the long-run? By the introduction of investment tax credit, government directly subsidizes the cost of new plant and equipment—or expensing—in which business write off the purchase of new plant and equipment at all once rather than gradually.