Soochow University, Winter Session I, 2021
ECON202
Discussion Session II

Question 1. Explain how each of the following events affect the money multiplier, and the money supply.

(a) The Federal Reserve buys bonds in an open-market operation.

(b) The Fed increases the interest rate it pays banks holding reserves.

(c) Rumors about a computer virus attack on ATMs increase the amount of money people hold as currency rather than demand deposits.

(d) The Fed flies a helicopter over the Santa Cruz Boardwalk and drops newly printed $100 bills.

Question 2. A macroeconomist threatens to call the Secret Service to have Mr. Biggy Rich arrested for counterfeiting because Mr. Rich claims he "makes a lot of money."

(a) Explain why the macroeconomist is making this threat based on the macroeconomic definition of money. Be sure to explain the macroeconomic functions of money.

(b) Suggest an alternative phrase that Mr. Rich can use that will not result in a charge of counterfeiting.

Question 3. Why do we not use purchasing power parity theory in the short-run? Explain your reasoning.

Question 4. The Economist publishes the Big Mac Index as an informal way of measuring the purchasing power parity (PPP) between two currencies. This index compares the cost of a single Big Mac burger as sold by different McDonald's restaurants across the world. The following information comes from the July 2020 Index:

Country	Big Mac Price (local currency)	Exchange Rate [1]
United States [2]	$5.71	1
Norway	Kroner 52.0	9.37105
Euro Area [3]	€4.21	0.8796235
China	Yuan 21.7	7.0035
Britain	£3.39	0.79255
Russia	Rouble 135	70.585
Canada	C$6.88	1.3552

[1] Foreign currency per unit of dollar.
[2] Average across different cities.
[3] Weighted average of prices in the euro area.

(a) If purchasing power parity held, what would you expect to be the local price of Big Macs in each country, taking by reference the U.S. price? Explain.

(b) Calculate the cost in dollars of a Big Max for each country, given the exchange rate observed in July 16. Assuming that all other goods are priced similar to the Big Mac, which countries are the cheapest and most expensive for Americans to visit?

Question 5. Case Study: – Read the scenario and answer the questions given the information below.

You're 25 years old and you work in the back office of a popular family restaurant. You're in charge of ordering everything that the restaurant needs and, over the last three months, you've noticed that the prices of key ingredients, like beef, have significantly increased. This wasn't a big deal before, but now it's affecting the restaurant's profit. To figure out what's going on, you read a short article about inflation. You also learn that the inflation rate in your country is 7.54%, which is 3% higher than economists forecasted.

(a) The price of beef has gone up over 60%. Is this entirely because of inflation? Why or why not?

(b) Why doesn't "core inflation" include the prices of food or energy?

(c) The price of lettuce has fallen 10%. How this possible if the inflation rate is 7.54%?

(d) What is the downside of changing the prices on the restaurant's menu to keep up with inflation?

(e) The owner of the restaurant offered to give you a 2% raise. Adjusting for inflation, will your real wage increase, decrease, or stay the same? Why?

(f) Do you think that you should ask for a bigger raise? Why or why not?