**Week 11 Tutorial Solution**
ECON203: Macroeconomics 2
Dr. Lei Pan — Semester 2, 2019
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## Multiple Choice Questions

**Question 1.** The $FE$ line shows the level of output at which the ________ market is in equilibrium.
(a) Goods
(b) Asset
(c) Labour
(d) Money

**Answer**: C

**Question 2.** Which of the following would shift the $FE$ line to the right?
(a) An adverse supply shock
(b) An increase in labour supply
(c) A decrease in the capital stock
(d) An increase in the future marginal productivity of capital

**Answer**: B

**Question 3.** The $IS$ curve shows the combinations of output and the real interest rate for which
(a) the goods market is in equilibrium.
(b) the labour market is in equilibrium.
(c) the financial asset market is in equilibrium.
(d) an increase in output will cause the market-clearing interest rate to be bid up.

**Answer**: A

**Question 4.** An increase in the money supply would cause the $FE$ line to
(a) shift to the right.
(b) shift to the left.
(c) remain unchanged.
(d) remain unchanged if Ricardian equivalence holds; otherwise, shift to the right.

**Answer**: C

**Question 5.** Any change that reduces desired saving relative to desired investment (for a given level of output) causes the real interest rate to ________ and shifts the $IS$ curve ________
(a) increase; down and to the left
(b) increase; up and to the right
(c) decrease; down and to the left
(d) decrease; up and to the right

**Answer**: B

**Question 6.** A decline in expected future output would cause the $IS$ curve to
(a) shift up and to the right.
(b) shift down and to the left.
(c) remain unchanged.
(d) shift up and to the right only if people face borrowing constraints.

**Answer**: B

**Question 7.** A decrease in wealth would cause the $IS$ curve to
(a) shift up and to the right.
(b) shift down and to the left.
(c) remain unchanged.
(d) shift up and to the right only if people face borrowing constraints.

**Answer**: B

**Question 8.** A rise in the price of a bond causes the yield of the bond to
(a) rise.
(b) fall.
(c) remain unchanged.
(d) rise if it's a short-term bond, fall if it's a long-term bond.

**Answer**: B

**Question 9.** A change that increases the real money supply relative to real money demand causes
(a) the $LM$ curve to shift down and to the right.
(b) the $LM$ curve to shift up and to the left.
(c) the $IS$ curve to shift down and to the left.
(d) the $IS$ curve to shift up and to the right.

**Answer**: A

**Question 10.** You have just read that the Reserve Bank of Australia has increased the money supply to avoid a recession. For a given price level, you would expect the $LM$ curve to
(a) shift up and to the left as the real money supply falls.
(b) shift up and to the left as the real money supply rises.
(c) shift down and to the right as the real money supply falls.
(d) shift down and to the right as the real money supply rises.

**Answer**: D

## Problem Solving Questions

**Question 11.** What are IS shocks and give an example from the real world?

**IS shock are exogenous changes in the demand for goods and services. For example, change in business or consumer confidence or expectations. This will lead to change in Investments and/or change in Consumption.**

**Question 12.** What are LM shocks and give an example from the real world?

**Exogenous changes in the demand for money. For instance, a wave of credit card fraud increases demand for money.**

**Question 13.** How does the efficiency of monetary policy depend on the shape of IS curve (and why)?

**The flatter the IS curve the more effective monetary policy is (income will rise much). As a rise in money supply lowers the interest rate, investments rise more in response to the fall in interest rate, so output rises more.**

**Question 14.** Explain the spending hypothesis of determinants of the Great Depression.

**Asserts that the Depression was largely due to an exogenous fall in the demand for goods and services, a leftward shift of the IS curve. Output and interest rates both fell, which is what a leftward shift of the IS curve.**