ECON 2002.01 Problem Set 9

Unit 15

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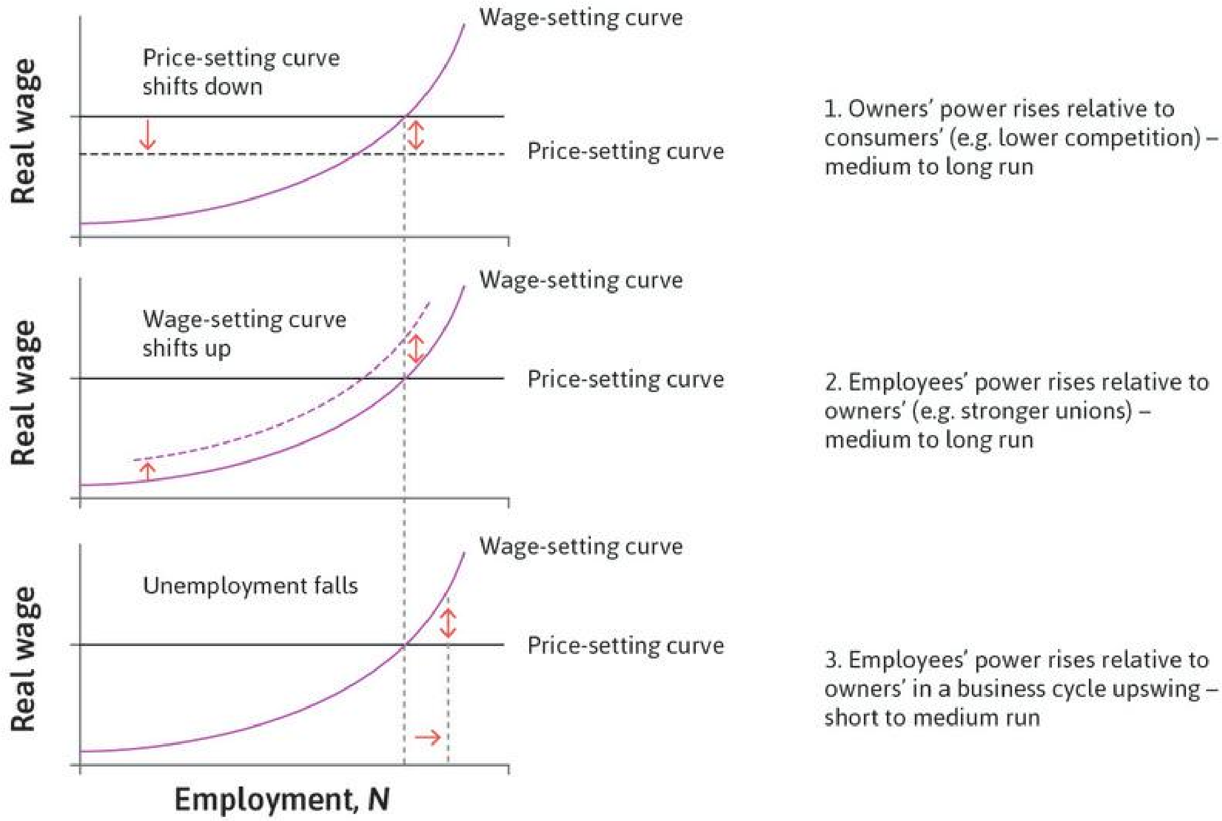
1. (OUP-U15-Q2) Which of the following is a definite consequence of a high inflation rate? _____

   (A) It reduces everyone's real wealth and real income.
   (B) It makes borrowing more expensive.
   (C) It makes poor people worse off.
   (D) It can distort price signals.

2. (OUP-U15-Q5) Imagine that the rate of inflation has been 10 per cent per year for a number of years. The central bank then introduces a 'tight' monetary policy and the rate of inflation comes down to 5 per cent per year. This reduction is an example of: _____

   (A) Deflation.
   (B) Falling prices.
   (C) Disinflation.
   (D) Austerity.

3. (OUP-U15-Q11) Suppose that the bargaining power of workers rises relative to that of employers because government legislation improves the security of employment. In terms of the wage-setting/price-setting model shown in the figure:



______

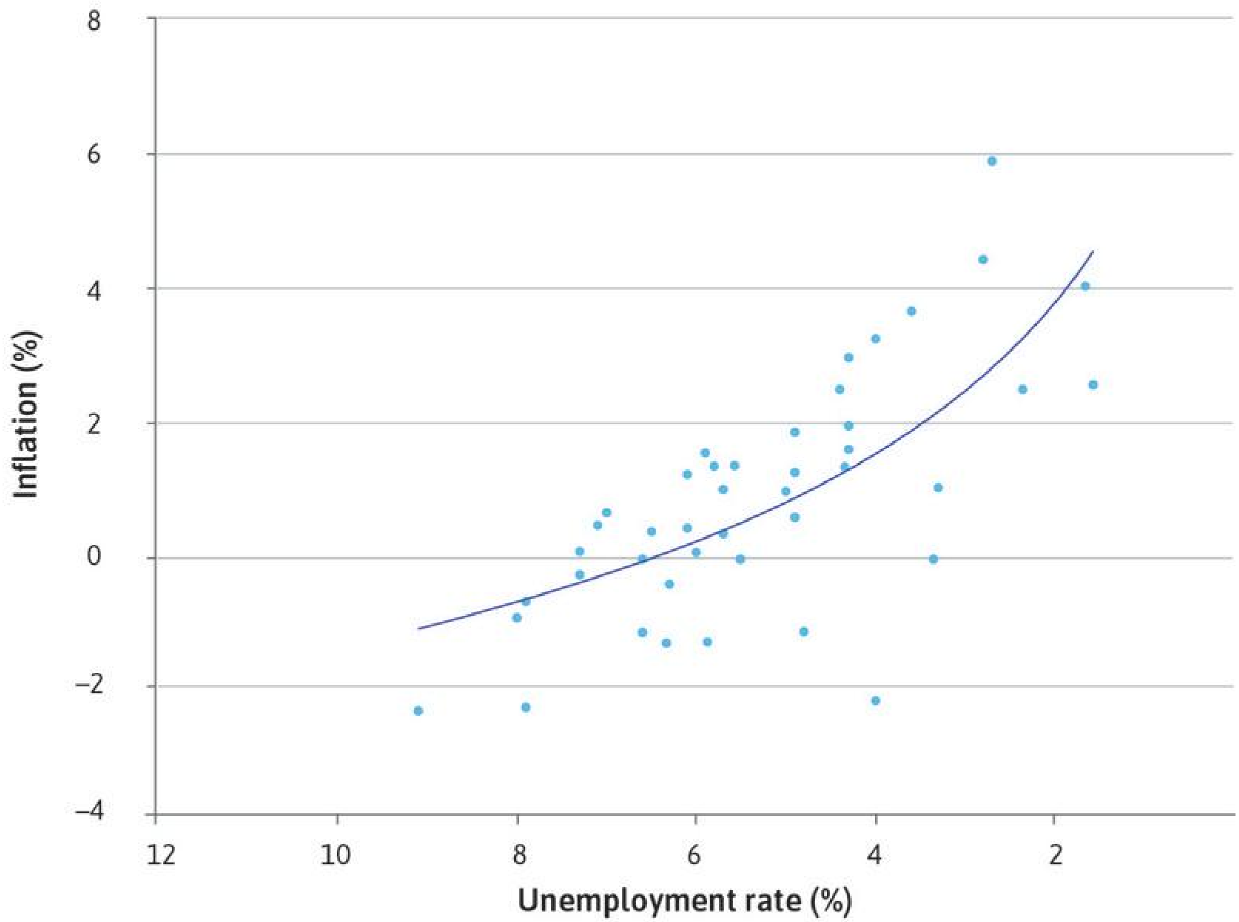
(A) We move along the wage-setting curve, to the right.

(B) The wage-setting curve moves up.

(C) The wage-setting curve moves down.

(D) The wage-setting curve becomes flatter.

4 (OUP-U15-Q17) The original Phillips curve shown in the figure suggested that the policymaker could choose:



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(A) Any preferred level of unemployment and inflation.

(B) Any preferred rate of inflation, for a given level of unemployment.

(C) A stable combination of inflation and unemployment.

(D) A temporary combination of inflation and unemployment.

5 (OUP-U15-Q20) Assume that a bargaining gap remains constant at 1 per cent. The rate of inflation in future years will: _____

(A) Remain constant at 1 per cent per year.

(B) Remain unchanged.

(C) Accelerate by 1 per cent per year.

(D) Settle at 1 per cent.

6. (OUP-U15-Q22) Assume that the central bank has an inflation target of 2% per year but inflation is currently running at 4%. The nominal policy (interest) rate is currently 5%. The central bank needs to create a negative bargaining gap and estimates that the real policy rate required to achieve this is 3%. Consequently it needs to set the nominal policy rate at: _____

   (A) 6%.

   (B) 7%.

   (C) 8%.

   (D) 4%.

7. (OUP-U15-Q25) It is often said that independent central banks are more likely to run a successful monetary policy than governments because their commitment to low inflation is more ‘credible’ than government promises. One reason for this is that: _____

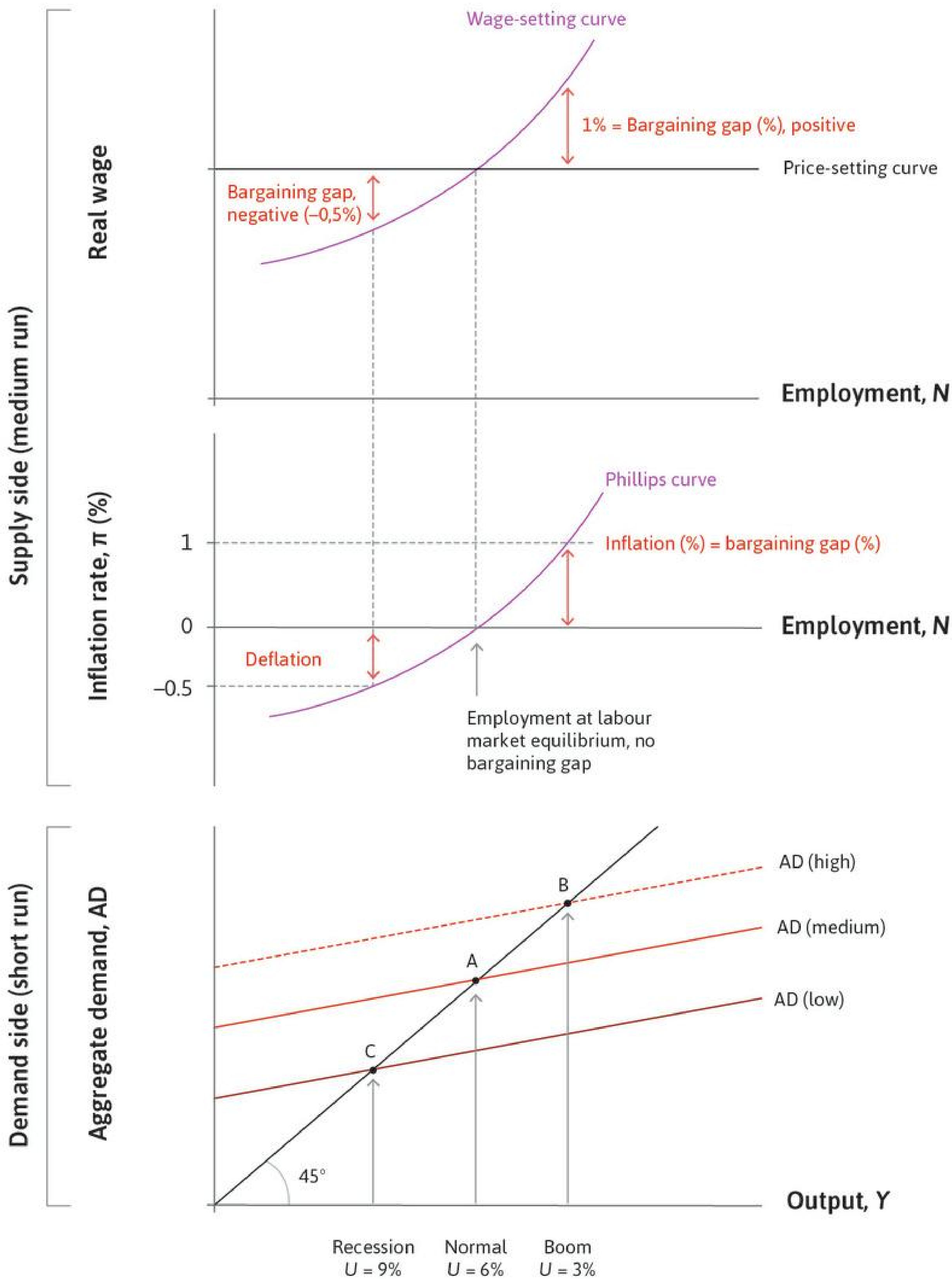
   (A) Independent central banks are better at economic forecasting.

   (B) People who work in central banks have a strong dislike of inflation.

   (C) Central banks can set interest rates.

   (D) Central banks are less subject to political pressures (e.g. for lower unemployment) than governments.

8. (ECO-U15-Q5) See Figure 15.4d for diagrams of the labour market model, the Phillips curve, and the multiplier model of aggregate demand. The unemployment rates and the bargaining gaps at different states of the economy are shown. Based on this information, which of the following statements is correct?


Supply side (medium run)
Real wage
Wage-setting curve
1% = Bargaining gap (%), positive
Price-setting curve
Bargaining gap, negative (–0,5%)
Employment, N
Inflation rate, π (%)
Phillips curve
1
Inflation (%) = bargaining gap (%)
0
Employment, N
Deflation
–0.5
Employment at labour market equilibrium, no bargaining gap
Demand side (short run)
Aggregate demand, AD
AD (high)
B
AD (medium)
A
AD (low)
C
45°
Output, Y
Recession U = 9%
Normal U = 6%
Boom U = 3%

(A) There is no inflation when the unemployment rate is zero.

(B) In the boom shown, the upward shift in the aggregate demand curve reduces the unemployment rate, which in turn creates a bargaining gap of 1%.

(C) In the recession shown, the downward shift in the aggregate demand curve increases the unemployment rate, which in turn creates a bargaining gap of 0.5%.

(D) The resulting Phillips curve shows a positive correlation between the unemployment rate and inflation rate.

9. (OUP-U15-Q18) The main weakness of the original Phillips curve is that it ignored: _____

(A) Time.

(B) Household preferences.

(C) Policymaker preferences.

(D) Expectations.

10. (OUP-U15-Q25) It is often said that independent central banks are more likely to run a successful monetary policy than governments because their commitment to low inflation is more 'credible' than government promises. One reason for this is that: _____

(A) Independent central banks are better at economic forecasting.

(B) People who work in central banks have a strong dislike of inflation.

(C) Central banks can set interest rates.

(D) Central banks are less subject to political pressures (e.g. for lower unemployment) than governments.