TOBB-ETU, Economics Department

Macroeconomics II (IKT 234)

Expectations - Practice Questions (Ozan Eksi)

CH 14

1. Suppose you will receive \$100,000 each year for the next two years, beginning in one year. Calculate the present value of this sequence of payments when the interest rate is:

a-) 0

b-) 4 %

c-) 8 %

d-) 4% in the first year, 8% in the second year

ANS:

$$\frac{100,000}{1+0.00}+\frac{100,000}{(1+0.00)^2}=200,000$$

$$\frac{100,000}{1+0.04}+\frac{100,000}{(1+0.04)^2}=188,609$$

$$\frac{100,000}{1+0.08}+\frac{100,000}{(1+0.08)^2}=178,327$$

$$\frac{100,000}{1+0.04}+\frac{100,000}{(1+0.04)(1+0.08)}=185,185$$

2. Suppose you are to receive a sequence of future payments. The PV of this sequence of payments -in nominal terms- will increase as:

a-) the nominal interest rate increases

b-) the nominal interest rate falls

c-) the higher the value of the future payments

d-) both b and c

ANS: D

3. Which of the following expressions represents the exact definition of the real interest rate?

a-) $i - \pi^e$

b-) $1 - \pi^e$

c-) $(1 + i)/(1 + \pi^e)$

d-) $[(1 + i)/(1 + \pi^e)] - 1$

ANS: D

4. In the short run, an increase in money growth will cause:

a-) an increase in i and an increase in r

b-) an increase in i and a reduction in r

c-) a reduction in i and a reduction in r

d-) a reduction in i and an increase in r

ANS: C

CH 15

1. Use the information provided below to answer the following questions about one-year and two-year bonds that make a \$1000 payment upon maturity: i_{1t}=10% and i^e_{1t+1}=8%.

a-) What is the price of the one-year bond today?

b-) What is the price of the two-year bond today?

c-) What is the price of the two-year bond in one year?

ANS:

$$\frac{1,000}{1,1} = 909,09$$

$$\frac{1,000}{1,1 * 1,08} = 841,75$$

$$\frac{1,000}{1,08} = 925,93$$

2. Suppose the one-year rate is 5% and that i^e_{1t+1}=7%. Calculate the current two-year interest rate. What is the shape of the yield curve?

ANS: 6%. Upward sloping.

3. An increase in the yield to maturity on a two-year bond will cause:

a-) a reduction in $\$P_{2t}$

b-) an increase in $\$P_{2t}$

c-) the maturity on the two-year bond to increase

d-) none of the above

ANS: A

4. Suppose the yield curve is initially upward sloping. Use your knowledge of the IS-LM model and the yield curve to explain what effect each of the following events will have on the shape of the yield curve.

a-) financial markets expect a future reduction in consumer confidence which results in a reduction in consumer spending

b-) financial markets expect a future FED monetary expansion

c-) financial markets expect a future reduction in government spending which is accompanied by a FED monetary expansion

d-) financial markets expect a future tax cut

ANS:

a-) b-) c-) the expected future one-year rate will fall, causing the yield curve to become flatter

d-) the expected future one-year rate will increase, causing the yield curve to become steeper

CH 16

1. A reduction in the current and expected future real interest rates will cause:

a-) the present value of expected profit to increase

b-) the present value of expected profit to decrease

c-) a reduction in investment

d-) a reduction in the rate of depreciation

ANS: A

2. Which of the following events would cause an increase in human wealth?

a-) an increase in the amount in one's savings account

b-) a reduction in expected taxes

c-) an increase in the value of one's house

d-) an increase in the expected future real interest rate

ANS: B

CH 17

1. Briefly note how each of the following events affects: (1) each of the components of current spending; (2) the position of the IS curve in the current period; and (3) the position of the LM curve in the current period.

a-) reduction in expected future real dividends

b-) increase in expected future real after-tax profits

c-) reduction in expected future taxes

d-) reduction in expected future real interest rates

e-) reduction in expected future income

ANS:

a-) reduces nonhuman wealth; causes a reduction in consumption; causes a leftward chift in the IS curve

b-) increases the present value of after-tax profits; increases investment, causes a rightward chift in the IS curve

c-) increases human wealth; increases consumption, causes a rightward chift in the IS curve

d-) increases nonhuman wealth; increases the present value of after-tax profits, increases investment, causes a rightward chift in the IS curve

e-) reduces human wealth, therefore consumption, decreases expectations of future profit, therefore, investment; IS shifts to the left

2. An increase in current income will cause:

a-) an increase in the nominal interest rate and a movement along the LM curve in the current period

b-) the LM curve to shift up in the current period

c-) the LM curve to shift down in the current period

d-) the LM curve in the current period to become flatter

ANS: A

3. The effects of a monetary expansion on economic activity in the current period depend on:

a-) whether financial markets alter their expectations of future nominal interest rates

b-) whether financial markets alter their expectations of current and future expected inflation

c-) both a and b

d-) none of the above

ANS: C

4. Assume that individuals consider only the short run e§ects of changes in expected future macroeconomic variables. Suppose individuals expect that future government spending will increase and expect that the FED will not respond to this. Individuals will, therefore, expect:

a-) future income to increase

b-) future interest rates to increase

c-) the IS curve to shift to the right in the future

d-) all of the above

ANS: D

5. Assume that individuals consider only the medium-run effects of changes in expected future macroeconomic variables. Suppose individuals expect that future government spending will increase and expect that the FED will not respond to this. Individuals will, therefore, expect:

a-) future income to increase

b-) future interest rates to increase

c-) future investment to increase

d-) all of the above

ANS: B

6. Assume that individuals consider only the long-run effects of changes in expected future macroeconomic variables. Suppose individuals expect that future government spending will increase and expect that the FED will not respond to this. Individuals will, therefore, expect:

a-) future income to decrease

b-) future income will not change

c-) future investment to increase

d-) all of the above

ANS: A