Surname \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Name\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Student id. no. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Economics II – A.Y. 2018/19**

**Midterm exam**

**Notes:**

- This is a closed-book exam (i.e. no books, cell phones, slides, notes…)

- Students seen (or suspected of) cheating must leave the room (you will be given only one notice, the second notice is “exam failed”).

- Please answer all questions using only the “white spaces” below questions.

- Please do not hand-in anything else but these sheets.

- Time: 1 hour.

- PART 1. State if the statements are TRUE or FALSE, and MOTIVATE your answers.

- PART 2. Provide an exhaustive answer to the open question.

- Hints: Define economic concepts, define symbols, label graph axes, explain and motivate carefully each statement in your answers. Use the last few minutes to read everything.

**Q1. (5 points) Equilibrium in the goods market. A decrease in autonomous consumption (*c*0) leads to proportional decrease in output. True or false? Define the economic meaning of *c*0 (1 point). Represent the equilibrium in the goods market in a graph defining the component of aggregate demand in a closed economy (3 points). Use the graph to describe what happens when *c*0 decreases (1 points).**

**Q2. (5 points) Equilibrium in the financial market. In the US the Fed Fund Rate (FFR) is determined by the condition “money demand” = “money supply” where money demand equals demand for currency. True or false? What is the FFR (1 point)? How is money demand determined in this setting and by who is determined (1 point)? Sketch how the equilibrium FFR is determined (2 points). Hint: equations not required.**

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**Q3. (5 points) Equilibrium in the labour market. The natural rate of unemployment (*un*) is derived under the condition that price level is equal to the expected price level. True or false? How is calculated the rate of unemployment, *ut* (1 point)? What is *un* (1 point)? Use the wage-setting (WS) and price-setting (PS) equations to draw a conclusion (3 points). Hint: briefly define the variables in the WS and PS relations and sketch how *un* is determined.**

**Q4. (5 points) The expectation augmented Phillips curve (PC). If the unemployment rate, *ut*, is equal to the natural rate of unemployment, *un*, the inflation rate tends to remain stable. True or false? Define the inflation rate (1 point). Describe how the PC with expectations can be used to describe the relation between changes in inflation and unemployment, show this with an equation and describe all variables and parameters in this equation (3 points). Use this equation to describe in economic terms what happens when *ut* = *un*.**

**Q5. (10 points) The IS-LM model. Describe and represent in a graph the equilibrium in the financial market when money demand equals demand for currency (2 points). Derive the LM curve from the equilibrium in the financial market and describe with graphs and words (2.5 points). Describe the IS curve, its components and represent the IS-LM model in a graph (2.5 points). Describe the effects of an increase in real money supply (3 points).**