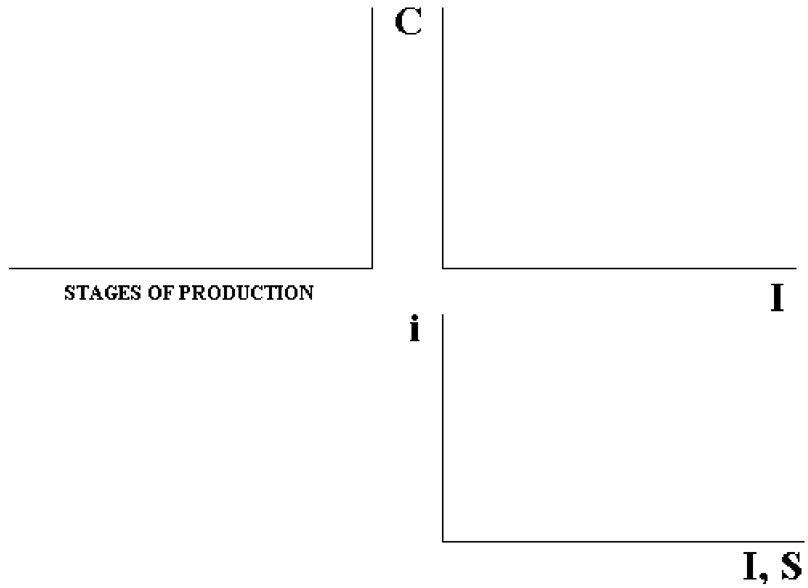
ECON 2030: STUDY PROBLEM IN CAPITAL-BASED MACROECONOMICS

The accompanying set of axes provides the framework for depicting the relationships of capital-based macroeconomics. Draw the appropriate relationships in each of the three quadrants and establish (graphically) the equilibrium levels of all the variables.

Assume that, initially, gross investment just offsets capital depreciation.

Now, suppose the Federal Reserve expands the money supply in an attempt to stimulate economic growth. Show this development and its consequences graphically and then respond to six questions below.



1. In a healthy economy the equilibrium quantity of loanable funds is better understood as
A. the transactions component of the money supply.
B. the entire money supply.
C. the quantity of investable resources.
D. the real output of a fully employed economy.

2. The monetary expansion is shown by adding the increase in the money supply
A. vertically to the demand for loanable funds.
B. horizontally to the supply for loanable funds.
C. vertically to the supply for loanable funds.
D. horizontally to the demand for loanable funds.

3. The initial effect of the increase in the money supply will include
A. an increase in the interest rate and an increase in saving.
B. a decrease in the interest rate and an increase in saving.
C. an increase in the interest rate and a decrease in saving.
D. a decrease in the interest rate and a decrease in saving.

4. The *initial* movement of the economy away from its equilibrium on the PPF will be a movement
A. clockwise along the PPF.
B. counterclockwise along the PPF.
C. outward beyond the PPF.
D. inward into the interior of the PPF.

5. The time-discount effect of the monetary expansion will cause
A. long-term projects to appear more profitable.
B. income-earners to increase their saving.
C. short-term projects to appear more profitable.
D. saving to exceed investment.

6. Had the increase in the supply of credit been attributable to an increase in saving rather than an increase in the money supply, the consequences for the macroeconomy would have been
A. an initial decrease in consumption, followed by sustainable economic growth.
B. an initial increase in consumption, followed by sustainable economic growth.
C. an initial decrease in consumption, followed by a boom and subsequent bust.
D. an initial increase in consumption, followed by a boom and subsequent bust.