This exam was created by Professor Scott Cawfield for students using Parkin/Bade, *Macroeconomics: Canada in the Global Environment*, Fourth Edition.

Indicate whether the following is True (T), or False (F) **(15)**

______1. M1 includes currency, demand deposits, and savings deposits. **F**
______2. M2+ includes currency, demand deposits, personal savings deposits at the chartered banks, nonpersonal deposits at chartered banks, all deposits at other financial institutions. **T**
______3. Assets = Liabilities – Net Worth **F**
______4. Actual Reserves + Desired Reserves = Excess Reserves **F**
______5. The banks loan out their excess reserves. **T**
______6. By making loans, the banks create new money. **T**
______7. The interest rate is the amount received by a lender, or paid by a borrower, expressed as a percent of the loan, or investment. **T**
______8. The exchange rate is the price of borrowing money. **F**
______9. When the interest rate rises, the demand for money will also rise. **F**
______10. In the 1990s, the real GDP of Canada increased by #$130 Billion Canadian. During this time, the demand for M1 and the demand for M2+ rose. **T**
______11. There are two balance of payments accounts: the Current account, and the Capital account. **F**
______12. A country that has a current account deficit and borrows more from the rest of the world than it lends to it is called a *net borrower*. **T**
______13. The labour cost of a unit of output equals a unit of output divided by labour productivity. **F**
______14. The temptation to impose tariffs on the part of governments is a strong one. **T**
______15. A trade war occurred during the Great Depression in the 1930s when many Western countries turned to **protectionism**. **T**

Multiple Choice Questions **(15)**

______1. The functions of money include the following: A. a medium of exchange B. able to be deposited C. all of the above. **A**
______2. A central bank is one which is A. operated by the U.N. B. charged with regulating a country's monetary and financial institutions and markets. C. none of the above. **B**
______3. The central bank in Canada was created A. during the Depression years. B. by John A. MacDonald. C. by Trudeau in 1968. **A**
______4. The central bank in Canada is considered, among world central banks, to be A. independent of the government. B. Subordinate to the government. C. neither. **B**
______5. The Governor of the Bank of Canada is considered to have A. no autonomy. B. substantial autonomy and discretion. C. be a member of the government. **B**
______6. Money includes A. Chequing accounts. B. Bonds and stocks. C. Neither of the above. **A**

______7. Liquidity is the characteristic of A. being a bit watery. B. being easily converted to cash. C. bearing interest payments. **B**

______8. The following would be considered liquid: A. House. B. Equities. C. Short-term Treasury bills. **C**

______9. If we say the Bank of Canada is accelerating the economy, it means that the Bank of Canada is: A. raising interest rates. B. lowering interest rates. C. deferring a decision on interest rates to the money markets. **B**

______10. If the Bank of Canada is taking actions to expand Canada's monetary base, this is called: A. Expansionary monetary policy. B. Contractionary monetary policy. C. Neutral monetary policy. **A**

______11. The North American Free Trade Agreement (NAFTA) is a 1994 agreement between: A. Canada, Mexico, Chile. B. Chile, Mexico, the United States. C. Canada, United States, Mexico. **C**

______12. APEC is proceeding on a free trade agreement among: A. the Atlantic Political nations. B. China, Canada, the United States, East Asia and South Pacific nations. C. China, the Philippines, Japan. **B**

______13. Infant industry is an argument to help young businesses A. by giving them subsidies. B. by giving them tariff protection. C. by giving them no taxes for the first three years. **B**

______14. A **VER** is A. a video machine refund from the government. B. an agreement between two countries where the government of the exporting country agrees to restrain the volume of its imports. C. a new tax being considered by government. **B**

______15. The **foreign exchange rate** is the A. price of money in any economy. B. the price at which one currency exchanges for another. C. the price of foreign goods exchanged. **B**

Short Answer (45)

1. What are the 3 functions of money? (3 marks) **A) Medium of exchange, B) Unit of account, C) Store of value.**

2. What is the money in today's economy? (2 marks) **A) Currency/Notes & Coins, B) Bank deposits**

3. Name the 2 components of M1, and 3 components of M2+. (5 marks) **M1: A) Currency, B) Demand deposits/chequing accounts in chartered banks. M2: A) Savings accounts in chartered banks, B) Nonpersonal (bankers') deposits in chartered banks, C) All deposits at other financial institutions**

4. Susy takes $1,000.00 for her chequing account at Royal Bank, and deposits it into her savings account at TD Canada Trust. What happened to M1 and to M2+? (2 marks) **M1 has declined by $1000, M2 hasn't changed.**

5. Which of the following is money, and which is not: A. A Canadian $50 note B. A loonie C. A Government of Canada Bond D. A Microsoft share. (3

marks) **The $50 notes and the loonie are money, the bond and share are not money.**

6. Give two functions of financial institutions which have to do with debt. (2 marks) **For borrowers, financial institutions minimize the cost of borrowing. For banks, they pool the risk of defaulters.**

7. Because of new deposits, the banks find they have $1,000,000.00 in reserves. They desire to hold in reserve only $200,000.00. How much money will they loan? (1 mark) **The correct answer is $800,000. ($1,000,000 - $200,000 = $800,000)**

8. If the desired reserve ratio is 0.2, what is the deposit multiplier? (1 mark)

   $\frac{1}{0.2} = \frac{1}{1/5} = 5$ **. 5 is the deposit multiplier.**

9. State the two ways the **deposit multiplier** formula can be expressed. (2 marks)

   $$\frac{\text{Change in Deposits}}{\text{Change in Reserves}} \text{ or } \frac{1}{\text{Desired Reserve Ratio}}$$

10. Why would $100,000 in new deposits in Canadian banks not always result in new deposits of $400,000 and loans of $300,000? (1 mark) **Parts of loans are not redeposited – they get held as currency ("currency drain").**

11. As the price level rises, what happens to the demand for money? (1 mark) **The demand for money increases.**

12. As GDP declines, what happens to the demand for money? (1 mark) **The demand for money would decline or decrease.**

13. As the interest rate rises, what happens to the demand for money? (1 mark) **The demand for money would decline/decrease/go down.**

14. $1,200.00 is deposited in a TD bank. The desired reserve ratio is 0.1. What will be the total increase in bank deposits and money? (Show all work for 2 marks)

   $$\$1200 \times \frac{1}{0.1} = \$1200 \times 10 = \$12{,}000$$

15. As the interest rate rises, what happens to the price of bonds? Explain in terms of the selling or buying of bonds. (2 marks) **People will buy bonds, the price of bonds will go down, interest rates will decline again.**

16. If a bank has reserves of $100,000,000.00 and deposits of $25,000,000.00, what is its net worth? (1 mark) **Assets – Liabilities = Equities, therefore $100,000,000 - $25,000,000 = $75,000,000.**

17. If a bank has deposits of $200 million, and net worth of $1,000 million, what are its assets? (1 mark) **Assets = Liabilities + Net Worth (or equities), therefore Assets = $200,000,000 + $1,000,000,000 or $1.2 billion.**

18. What is George Bush's #1 priority for the U.S. economy? (1 mark) **George Bush's #1 priority is to give the U.S. taxpayer a major tax cut and stimulate new spending.**

19. What is the Central Bank of Canada trying to do to the Canadian economy? (2 marks) **The Bank of Canada is trying to keep interest rates low to expand the economy. (Also acceptable: to keep exchange rates low to grow the economy.)**

20. The U.S. economy lost 80,000 jobs in March this year, while the Canadian economy created 30,000 new jobs. How can you explain these figures? (2 marks) **The U.S. economy is near 0% growth – almost near a recession. The Canadian economy is still growing, about 2%.**

21. Give three aspects of **monetary policy**. (3 marks) **A) Control the quantity of money in the economy, B) Control inflation, C) Control interest and exchange rates.**

22. Define **Overnight Loans Rate**. (1 mark) **The Overnight Loan Rate is the rate banks charge each other on large loans.**

23. Explain what the **Bank Rate** is. (1 mark) **The Bank Rate is the rate the Bank of Canada charges the chartered banks on loans. (Extra point: It is kept at the low end of the overnight loan rate.)**

24. Is the Canadian central bank independent, or subordinate? Is the U.S. central bank subordinate, or independent? Which appears to function more effectively, in your view? (2 marks) **The Canadian bank is subordinate. The U.S. bank is independent. Many economists view the Canadian bank as doing a good job recently.**

25. Using the car analogy, what is the central bank doing when it A. **puts on the brakes** B. **accelerates**. (Be complete in your answer for 2 marks) **A. Puts on the banks = contracting the economy, raises interest and exchange rates. B. Accelerates = expanding the economy, lowers interest and exchange rates.**

Essays **(25) (Note carefully: These have to be written in logically expressed sentences and well organized paragraphs for marks. Writing in an incorrect way will get you no marks.)**

1. The Bank of Canada has four principal tools it can use to apply monetary policy, and either contract or expand the Canadian economy. Show four ways in which the Bank can contract or cool out the economy, and four ways in which it can expand the economy. What, in your view, is it doing for the economy this year? In your opinion, is this enough?

(10 marks, total): To contract the economy the Bank of Canada can first, raise the reserve ratios of the chartered banks. (1 mark) This means that the banks can lend out less money. Second, they can sell securities to the chartered banks, taking more money from the banks and out of the economy. (1 mark) Third, they can raise the bank rate; this would mean that the overnight loans rate and prime rate rise, making loans more difficult, and taking money out of the economy. (1 mark) Fourth, they can move bank deposits at the bank to the government of Canada's account, which leaves the banks with fewer reserves. (1 mark)

To expand the economy, the Bank of Canada can do all the opposite: they can lower the reserves ratio (1 mark), purchase securities from banks (1 mark), lower the bank rate (and the overnight loans rate and prime rate) (1 mark), and shift government deposits to the chartered banks to give them more money (1 mark).

The Bank of Canada is currently following an expansionary monetary policy (1 mark). The governor (David Dodge) has supported expansionary fiscal policy, too. (1 mark)

2. What kind of nations engage in international trade (mention two principles)? Identify and explain eight arguments for protectionism. Do you favour protectionism, or international trade? Why? Which nations are involved in NAFTA, and what are some of its objectives? Which nations should Canada be closest to in trade agreements?

(15 marks, total)