Economics 137 - Midterm

Directions: Answer all questions - point totals for each question are given in parentheses. You must provide complete explanations to receive credit for your answers.

1. (10) Based upon his article on fiscal policy, do you think John Taylor would support Greenspan’s views on the proposed cut in income taxes?

2. (15) What does M. Goodfriend mean by “go-stop” policy? Does this description coincide with Christina Romer’s view of post WWII monetary policy?

3. (10) Fed policy changed dramatically during the period 1979-82. Describe the nature of this change and the events that motivated it.

4. (10) The growth rate of the money supply has become more erratic in recent years. Using the model of the money supply developed in class, provide an explanation for this behavior.

5. (15) Suppose two countries have identical shocks to individual markets (i.e. the shocks have the same variance) but the variance of the inflation rate in Country A is greater than that in Country B. Based upon the imperfect information model, what is the implication for the aggregate supply curves in the two countries.

6. (15) a. Explain the intuition behind the expectations hypothesis of the term structure.
   b. Critical to the expectations hypothesis are forecasts of future interest rates. How would you test to see if these forecasts were made rationally (i.e. optimally).
   c. Under the assumption that the forecasts are indeed rationally, is the expectations hypothesis consistent with the data?