ECON 2630 – Practice Problems 10

1. If the interest rate dropped, what would be the effect on spending?
   a. Spending on automobiles would decrease.
   b. Business spending on new capital would decrease.
   c. Spending on consumer durables would decrease.
   d. Business spending on new factories would increase.
   e. Spending on new homes would decrease.

2. In the short-run macro model, an open-market purchase of bonds by the Fed will
   a. raise the interest rate, reduce spending, and increase output
   b. raise the interest rate, reduce spending, and decrease output
   c. lower the interest rate, reduce spending, and decrease output
   d. lower the interest rate, increase spending, and decrease output
   e. lower the interest rate, increase spending, and increase output

3. If government spending increases, which of the following is most likely to occur?
   a. GDP, money demand, the interest rate, and investment spending will all increase.
   b. GDP, money demand, the interest rate, and investment spending will all decrease.
   c. GDP, money demand and the interest rate will increase, while investment spending will decrease.
   d. GDP, money demand and the interest rate will decrease, while investment spending will increase.

4. Crowding out occurs
   a. when an increase in government spending crowds out tax revenues
   b. when an increase in government spending increases investment spending
   c. when an increase in government spending crowds out bonds
   d. when an increase in government spending crowds out consumer spending and investment spending

5. Suppose the public expects the interest rate to fall. As a result,
   a. the interest rate will not change now
   b. the interest rate will fall in the future
   c. the interest rate will rise now
   d. the interest rate will fall now

6. If the economy were encountering a severe recession, proper monetary and fiscal policies would call for:
   a. selling government securities, raising the required reserve ratio, lowering the discount rate, , and increasing government spending.
   b. buying government securities, reducing the required reserve ratio, reducing the discount rate, , and increasing government spending.
   c. buying government securities, raising the required reserve ratio, raising the discount rate, , and reducing government spending.
   d. buying government securities, reducing the reserve ratio, raising the discount rate, and reducing government spending.

Indy owns 100 shares of stock in Pet Mart Corporation that he purchased for $20 per share. Every year he has received, from company profits, $1 for each share he owns.

7. Refer to the information above. If Indy sells all his shares at a price of $30 per share, he will receive a:
   A. total capital gain of $10.
   B. dividend of $10 per share.
   C. total capital gain of $1,000.
   D. a capital gain of $30 per share.

8. Refer to the information above. If Indy holds his shares for 5 years, he:
   A. will have received $500 in dividends.
   B. will earn a capital gain of $500.
   C. will receive $500 in interest.
   D. should sell the stock to maximize the return on his investment.

9. Refer to the information above, Indy should necessarily sell his stock if:
   A. the price falls below $20 per share.
   B. he expects the sum of future capital gains and dividends to be negative.
   C. the company stops paying dividends.
   D. any of these circumstances occur.

10. Lee buys a bond for $10,000 and receives interest payments of $400 every six months. The interest rate on the bond is approximately:
   A. 4 percent.
   B. 8 percent.
   C. 12.5 percent.
   D. 25 percent.