

Homework 10 – KEY

Average: 86.09 + Opt GI bonus

Due on 7/4/2026, by 23:00

The tasks in this assignment were designed for the average student to solve independently after mastering the material. The answers provided here are written in an instructional manner to help you understand the problem-solving process for each task. If you continue to struggle with a task after reviewing this key, the difficulty may stem not from the task itself, but from having missed or overlooked some parts of the required material.

- 1[✓] Which of the following could be the target of Expansionary Fiscal Policy?
- A. To control inflation. *[EFP would put upward pressure on the price level]*
 - B. To decrease the government deficit. *[EFP tends to increase government deficit]*
 - 96% C. **To decrease unemployment.** *[EFP will stimulate production and incentivize firms to hire more workers]*
 - D. All of the above.
 - E. None of the above.
- 2[✓] How can a Central Bank accommodate Expansionary Fiscal Policy by the government in a scarce reserves regime?
- A. By increasing the government spending. *[Central Bank does not control the government spending]*
 - B. By increasing the tax coefficient. *[Central Bank does not control the tax coefficient]*
 - C. By increasing the interest rate. *[Accommodation means that the interest rate remains constant]*
 - 93% D. **By increasing money supply.** *[The increase in output resulting from the EFP will cause an increase in money demand. The CB will increase the money supply to relieve the pressure from the interest rate]*
- 3[✓] Which of the following is LESS likely to be affected by an increase in the money supply?
- A. The interest rate. *[A raise in money supply will reduce the interest rate]*
 - B. Private investment. *[It would increase, following the decrease in the interest rate]*
 - 95% C. **Government spending.** *[Central Bank's activity has nothing to do with Government spending]*
 - D. The equilibrium output. *[Since investment will increase, equilibrium GDP will increase too]*
4. Which of the following is accurate?
- A. A shock from the money market cannot be transmitted to the commodity market. *[False, can be transmitted with link 2]*
 - B. A shock from the commodity market cannot be transmitted to the money market. *[False, can be transmitted with link 1]*
 - 53% C. **A shock from the money market cannot be stabilized by the commodity market.** *[Correct, the commodity market cannot neutralize shocks]*
 - 42% D. A shock from the commodity market cannot be stabilized by the money market. *[False, the CB can stabilize shocks in the money market]*

5. Which of the following policies would be more suitable for a country with high government debt and high inflation?
- A. Expansionary monetary policy. *[Printing money could pay for debt but will create more inflation]*
 - 23%B. Contractionary monetary policy. *[It will decrease inflation but will not help with the debt]*
 - C. Expansionary fiscal policy. *[It would worsen both inflation and the debt]*
 - 76%D. **Contractionary fiscal policy.** *[Government deficit could improve, reducing the debt, plus the economy will cool down, thereby lowering inflation]*
6. Why investment and real interest rate are negatively related?
- 91%A. **Because the higher the real interest rate the costlier funding is for investment projects.** *[The interest rate represents the cost of borrowing; higher costs make fewer projects profitable]*
 - B. Because the higher the real interest rate the lower the expected return of investment projects. *[Expected returns depend on project's productivity and the market demand, not the prevailing market interest rate]*
 - C. Because the higher the real interest rate the lower the prices of goods produced by firms. *[Output prices are determined by supply and demand, not by the real interest rate]*
 - D. Because the higher the real interest rate the higher the risk of investment projects. *[A project's chance of failure depends on the business itself, not the interest rate]*
7. Which of the following is NOT accurate regarding the 2007-09 Financial Crisis?
- A. Many people lost their jobs even outside the banking/finance sector. *[High unemployment occurred across many industries as aggregate demand collapsed]*
 - 94%B. **Everyone tried to withdraw their deposits from banks.** *[There was no bank-run back then]*
 - C. Several major financial institutions collapsed. *[Indeed]*
 - D. A speculative bubble rapidly increased real estate prices. *[This was the main reason why the Crisis emerged]*
8. Which of the following is LESS likely to be the intention of Contractionary Fiscal Policy?
- 80%A. **To lower money demand.** *[Reduced money demand is a side effect of CFP, not its primary policy goal]*
 - B. To lower inflation. *[Cooling down the economy can lead to price reduction]*
 - C. To lower national debt. *[Both decrease in government spending and increase in taxes reduce government's deficit]*
 - 15%D. To increase government revenue. *[Increasing taxes would raise tax revenue for the government]*
9. From 2020 to 2025, Greece reduced its debt-to-GDP ratio from 200% to 150%, yet its real GDP increased by only 20%. Which of the following could explain these two seemingly contradictory facts?
- A. High inflation occurred in this period. *[Inflation allowed for higher nominal GDP]*
 - B. The government used budget surplus to pay back debt. *[Inflation led to higher tax revenue, which was used by the Government to pay its debt]*
 - 92%C. **Both A and B.**
 - D. None of the above.

10✓ A bank intends to lend out 100 million dollars. Which of the following involves the lowest risk in principle?

- 17%A. Lending \$100,000 to 1,000 different borrowers, each exposed to the same type of risk of default.
- 82%B. Lending \$1 million to 100 different borrowers, each exposed to a different type of risk of default.
- C. Lending \$100 million to a single borrower.
- D. All of the above involve the same level of risk.

[Diversification works best when risks are uncorrelated; different borrowers with different risks minimize total expected loss]