

METU

Department of Economics

ECON 102 (1-2): Introduction to Economics II

2024-2025 Spring Semester

PROBLEM SET 8

Q.1

a.) Distinguish between demand-pull inflation and cost-push inflation. Which of the two types is most likely to be associated with a negative GDP gap? Which with a positive GDP gap, in which actual GDP exceeds potential GDP?

b.) Can demand-pull or cost-push inflation keep going for a long time? If it can, how?

Q.2

Show whether each of the following transactions increase or decreases the demand for and the supply of foreign currency (or neither) in foreign exchange markets. What is the probable effect of each of the following on the exchange rate of TL, other things being equal? Treat each case separately and draw a separate diagram for demand / supply of US\$.

- a) Domestic income falls in Turkey, while it stays the same in other countries.
- b) Turkey increases purchases of weapons from the US.
- c) Turkey's inflation rate is higher than its trading partners.
- d) Higher interest rates in Turkey than in US encourage Turkish firms to borrow in US loan markets.

Q.3

Read the following transactions and fill in the blanks in the table below related to these transactions which are all independent from each other.

- A) A person from Türkiye buys Japanese automobile.
- B) Russian investors built a plant in Turkey.
- C) A Saudi Arabian corporation receives dividends from a Turkish subsidiary.
- D) Germans come to Turkey as tourists.
- E) Turkish investors buy Swiss stocks.
- F) A Turkish exporter sells textiles in Iranian market.

The transactions above would affect the foreign exchange markets (determine the effects of transactions in FX market in terms of shifts of supply or demand curves), the value of TL (determine the effects of transactions as appreciation or depreciation).

Transaction	Foreign Exchange Market	Value of TL
A		
B		
C		
D		
E		
F		

Q.4

Suppose an economy is represented by the equations below (Suppose that net investment income and net transfer payments are equal to zero).

$$C = 200 + 0.9 \cdot Y_d, \quad I = 200, \quad G = 252, \quad EX = 100, \quad IM = 0.12 \cdot Y_d, \quad T = 0.2 \cdot Y$$

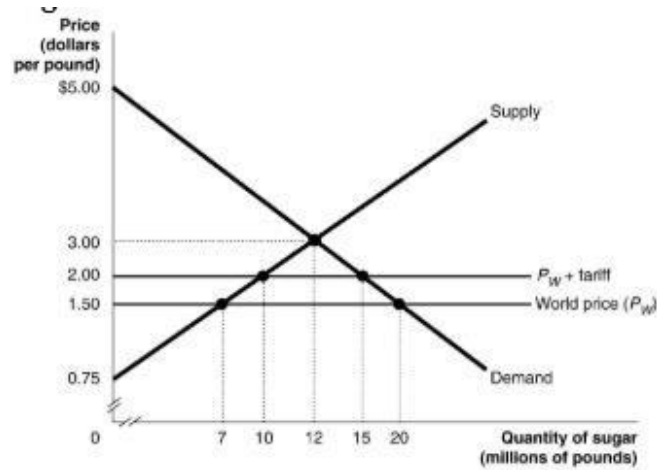
- a) Find equilibrium national income level for this economy.
- b) Find the value of the government multiplier.
- c) What is the value of this economy's current account?
- d) Without using any figures, how would a sudden depreciation of the national currency of this economy alter the equilibrium level of national income?

Q.5

Suppose that there are two countries; the UK and the US. Explain the effects of an increase in the British overall price level on the foreign exchange market of the UK by using a graph. (Hint: The horizontal axis of the graph is quantity of Dollars). Write down the effects by referring to the changes in foreign trades of the UK and the US.

Q.6

Suppose the Wonderland government imposes a \$0.50 per pound tariff on sugar imports. The figure below shows the demand and supply curves for sugar and the impact of this tariff.



- i) Assume that the economy is closed. What are the equilibrium price and quantity?
- ii) Now, assume that the economy opens up. What are the world price and quantity sold by domestic producers? (Be careful, there is no tariff imposition in this question.) What is the amount of imports?
- iii) Following the imposition of the tariff, what is the new price that consumers pay? What is the new quantity demanded?
- iv) Calculate the value of consumer surplus with the tariff in place.
- v) What is the quantity supplied by domestic sugar producers with the tariff in place?

- vi) Calculate the value of producer surplus received by US sugar producers with the tariff in place.
- vii) What is the quantity of sugar imported with the tariff in place?
- viii) What is the amount of tariff revenue collected by the government?
- ix) The tariff has reduced consumer surplus. Calculate the loss in consumer surplus due to the tariff.
- x) What portion of the consumer surplus loss is redistributed to domestic producers? To the government?
- xi) Calculate the deadweight loss due to the tariff.

Q.7

Metuland is “small” and assumed to be unable to affect world prices. It imports tomatoes at price of 10 TL per box. The domestic supply and domestic demand curves for boxes are:

$$S = 60 + 20P$$

$$D = 1160 - 15P$$

- i) Assume Metuland is completely open to trade. What are the equilibrium price and quantity consumed? How much is produced domestically, and how much is imported?

- ii) Now consider the effect of an import quota of 400 boxes. What happens to the price of tomatoes and the quantity consumed?

- iii) Who wins and who loses? Discuss consumers, domestic producers (Be sure to compute the change in their welfare).

MULTIPLE CHOICE QUESTION

Q1) If a country's currency is determined only by the demand and supply for that country's currency, the country is said to have a

- A) floating exchange rate.
- B) fixed exchange rate.
- C) gold standard.
- D) managed float.

Q2) An increase in the value of the US dollar will

- A) reduce Canadian demand for winter homes in Florida.
- B) increase Canadian demand for winter homes in Florida.
- C) reduce the cost of homes in Florida for Canadian buyers.
- D) increase the cost of homes in Florida for American buyers.

Q3) Purchasing power parity is the theory that, in the long run, exchange rates should be at a level such that equivalent amounts of any country's currency

- A) will equalize nominal interest rates across countries.
- B) are valued inversely relative to the size of its GDP.
- C) should earn the same real rate of return.
- D) allow one to buy the same amount of goods and services.

Q4) If the average productivity of Turkish firms is rising more quickly than the average productivity of Argentinean firms, which of the following would you expect to see? (Argentina's currency is the peso.)

- A) an increase in the value of the peso relative to the TL
- B) a decrease in the prices of Argentinean products
- C) a decrease in the quantity demanded of Argentinean products relative to Turkish products
- D) an increase in the quantity demanded of Argentinean products relative to Turkish products

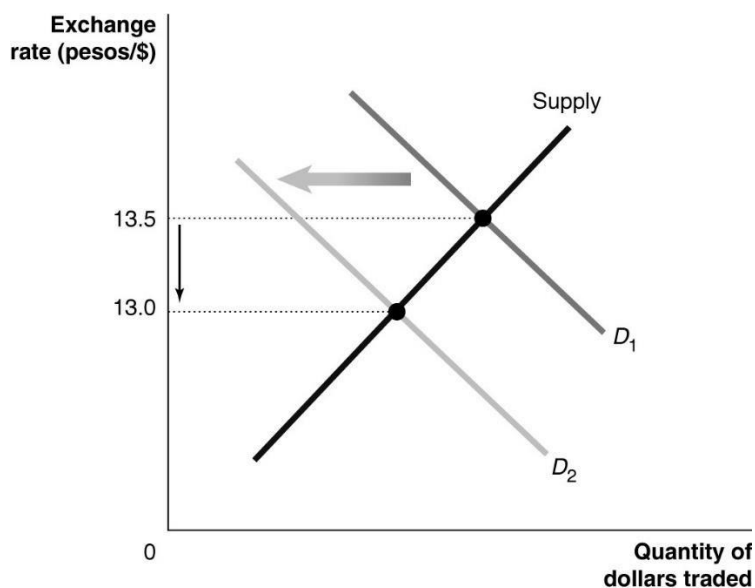
Q5) How will the exchange rate (TL per foreign currency) respond to an increase in the relative rate of productivity growth in the Turkey in the long run?

- A) Exchange rates will rise.
- B) Exchange rates will fall.
- C) Exchange rates will be unaffected by changes in the relative rate of productivity growth in the United States, both in the short run and in the long run.
- D) The exchange rate will be affected in the short run, but not in the long run.

Q6) If inflation in Russia is higher than it is in Turkey,

- A) the purchasing power of the ruble in buying Russian goods will rise relative to the TL.
- B) the value of the TL will rise in the long run.
- C) the value of the ruble will rise in the long run.
- D) Both A and C are correct.

Please answer the next two questions referring to the figure below.



Note that the peso is domestic currency.

Q7) Which of the following would cause the change depicted in the figure above?

- A) An increase in investment in infrastructure causes US productivity to rise relative to Mexican productivity.
- B) A growing preference for Margarita causes US consumers to increase their preferences for Mexican tequila relative to American-produced alcohol.
- C) Dumping accusations result in the United States placing tariffs on produce imported from Mexico.

D) A contractionary monetary policy causes a decrease in the price level of US goods relative to Mexican goods.

Q8) Which of the following would cause the change depicted in the figure above?

A) Lack of investment in infrastructure causes Mexican productivity to fall relative to American productivity.

B) A possibility of diseased poultry in Mexico causes US consumers to decrease their preferences for Mexican-raised chickens relative to U.S.-raised chickens.

C) A new trade agreement with Mexico results in the United States removing all tariffs on sugar imported from Mexico.

D) An expansionary monetary policy in Mexico causes an increase in the price level of Mexican goods relative to US goods.

Q9) If Californians increase their purchases of Italian wine, assuming all else remains constant, this will _____ of the United States.

A) decrease the balance of trade

B) increase net exports

C) increase the current account balance

D) decrease the trade deficit

Q10) The current account includes records of a country's

A) net exports.

B) net investment income.

C) net transfers.

D) All of the above are included in an economy's current account.

Q11) You're traveling in Ireland and are thinking about buying a new digital camera.

You have decided you would be willing to pay \$125 for a new camera, but cameras in Ireland are all priced in euros. If the exchange rate is 0.85 euros per dollar, which is the highest price in euros you would be willing to pay for a camera? (\$ is the domestic currency)

A) 105 euros

B) 106.25 euros

C) 110.15 euros

D) 147 euros

Q12) You're traveling in Ireland and are thinking about buying a new digital camera. You have decided you would be willing to pay \$125 for a new camera, but cameras in Ireland are all priced in euros. If the camera you are looking at costs 115 euros, under which of the following exchange rates would you be willing to purchase the camera? (\$ is the domestic currency and assume that no taxes or duties are associated with the purchase.)

- A) 0.56 euros per dollar
- B) 0.89 euros per dollar
- C) 0.92 euros per dollar
- D) You would purchase the new camera at any of the above exchange rates.

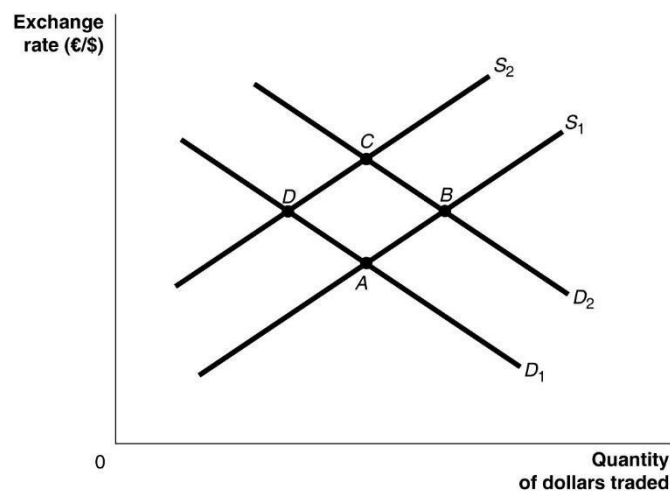
Q13) When the market value of the Turkish Lira rises relative to other currencies around the world, we say that

- A) the TL has appreciated.
- B) the TL has depreciated.
- C) the demand for TL has increased.
- D) the supply of TL has increased.

Q14) Currency traders expect the value of TL to fall. What effect will this have on the demand for TL and the supply of TL in the foreign exchange market?

- A) Demand for TL will increase, and the supply of TL will decrease.
- B) Demand for TL will increase, and the supply of TL will increase.
- C) Demand for TL will decrease, and the supply of TL will increase.
- D) Demand for TL will decrease, and the supply of TL will decrease.

Please answer the next four questions referring to the figure below.



Q15) The French fall in love with California wines and triple their purchases of this beverage. Assuming all else remains constant, this would be represented as a movement from

- A) B to A.
- B) C to D.
- C) A to D.
- D) A to B.

Q16) Europe suffers a recession. Assuming all else remains constant, this would be represented as a movement from

- A) D to A.
- B) C to D.
- C) B to C.
- D) A to D.

Q17) Suppose that the US government deficit causes interest rates in the United States to rise relative to those in the European Union. Assuming all else remains constant, how would this be represented?

- A) Supply would decrease, demand would decrease, and the economy moves from B to C to D.
- B) Supply would increase, demand would decrease, and the economy moves from C to B to A.
- C) Supply would decrease, demand would increase, and the economy moves from A to D to C.

D) Supply would increase, demand would increase, and the economy moves from D to A to B.

Q18) Italians cut back on smoking and cut their demand for American cigarettes in half. Assuming all else remains constant, this would be represented as a movement from

- A) B to A.
- B) D to C.
- C) B to C.
- D) A to D.

Q19) The balance of merchandise trade includes trade in

- A) goods only.
- B) services only.
- C) both goods and services.
- D) neither goods nor services.