

Economics 100b Midterm Review Problems
Chapter 8
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- 1) Suppose that an economy's money supply is \$50 billion, its real GDP is \$60 million, and its nominal GDP is \$150 million.
 - a. What is the price level? What is the velocity of money?
 - b. Suppose that the velocity is constant and output rises by 7% each year. What will happen to the nominal GDP and the price level next year if the central bank keeps the money supply constant?
 - c. What money supply should the central bank set next year if it wants to keep the price level stable?
 - d. What money supply should the central bank set next year if it wants an inflation of 5%?

- 2) Suppose money supply growth in a certain economy has been 2% over time, but suddenly jumps up to 5%. Using the Quantity Theory of Money and the Fisher equation, explain what effect this change would have on the nominal interest rate.

- 3) The country of Fredonia has been running a huge budget deficit for several years now. What can Fredonia do to reign in its deficit? What are the pros and cons of each approach?