Name: _____

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AP Macroeconomics — Practice Exam

Instructions: Section I style multiple choice (20 questions, five answer choices each, 1 point each) followed by one free-response question (10 points), 35 minutes in total. A four-function calculator is allowed, as on the real exam, but none is needed. Wrong multiple-choice answers are not penalized. On the free-response question, show your work for every calculation and draw graphs large, labeling all axes, curves and equilibrium points.

Time Limit: 35 minutes

Multiple Choice (20 questions)

[1 point] 1. Which of the following transactions is recorded as a credit (an inflow) in the capital and financial account of Pellona's balance of payments?

A. A Pellonian family buys a car imported from abroad

B. Foreign tourists pay for hotel stays in Pellona

C. A Pellonian bank buys bonds issued by a foreign government

D. A foreign pension fund buys bonds issued by the government of Pellona

E. Pellonian households receive dividends on shares they own in foreign companies

[1 point] 2. The table shows Rusvia's international transactions last year, in billions of ruvals (Rusvia's currency). Rusvia's current account balance for the year was:

Transaction	Billions of ruvals
Exports of goods	240
Imports of goods	290
Exports of services	85
Imports of services	60
Investment income received from abroad	30
Investment income paid to foreigners	45
Unilateral transfers received from abroad	4
Unilateral transfers sent abroad	12
Foreign purchases of Rusvian assets	95

A. a deficit of 56 billion ruvals

B. a deficit of 50 billion ruvals

C. a deficit of 48 billion ruvals

D. a deficit of 25 billion ruvals

E. a surplus of 47 billion ruvals

[1 point] 3. An electronics firm based in Galdor buys an existing factory in another country from its foreign owner. The factory then makes televisions that are shipped to Galdor and sold to Galdorian households. In Galdor's balance of payments, how are the purchase of the factory and the televisions recorded?

A. Factory: a credit in the capital and financial account; televisions: a debit in the current account
B. Factory: a debit in the capital and financial account; televisions: a credit in the current account
C. Factory: a credit in the capital and financial account; televisions: a credit in the current account
D. Factory: a debit in the current account; televisions: not recorded, because a Galdorian firm owns the factory
E. Factory: a debit in the capital and financial account; televisions: a debit in the current account

[1 point] 4. Which of the following, by itself, would increase Mirelle's current account balance (move it toward surplus)?

A. Foreign investors buy more shares in Mirellian companies
B. Mirellian households take more holidays in other countries
C. Mirellians working abroad send more money home to their families
D. Foreign-owned factories in Mirelle earn higher profits, which are paid to their foreign owners
E. Mirelle's government sends more foreign aid to other countries

[1 point] 5. The exchange rate between Tavaria's currency, the tav, and Sondermark's currency, the sond, changes from 1 tav = 4 sonds to 1 tav = 5 sonds. Measuring each currency's value by its price in terms of the other currency, which of the following is correct?

A. The tav has appreciated by 25 percent, and the sond has depreciated by 20 percent
B. The tav has appreciated by 20 percent, and the sond has depreciated by 25 percent
C. The tav has appreciated by 25 percent, and the sond has depreciated by 25 percent
D. The tav has appreciated by 20 percent, and the sond has depreciated by 20 percent
E. The tav has depreciated by 20 percent, and the sond has appreciated by 25 percent

[1 point] 6. In the foreign exchange market, 1 calv (the currency of Calvenna) trades for 6 durs (the currency of Durnholt), and 1 ess (the currency of Essery) trades for 1.5 durs. Ignoring transaction costs, how many esses does 1 calv buy?

A. 0.25 ess
B. 4 esses
C. 4.5 esses
D. 7.5 esses
E. 9 esses

[1 point] 7. The table shows the exchange rate of Ondara's currency, the ond, against the currencies of Rellia (the rell) and Brinmoor (the brin) in three consecutive years. Which of the following is correct?

Year	Rells per ond	Brins per ond
1	2.0	50
2	2.5	40
3	2.2	45

A. From year 1 to year 2, the brin depreciated against the ond, and the rell appreciated against the ond

B. From year 2 to year 3, the ond appreciated against the rell and depreciated against the brin

C. From year 1 to year 3, the ond appreciated against both the rell and the brin

D. From year 1 to year 2, the ond appreciated against the rell and depreciated against the brin

E. From year 1 to year 3, the ond depreciated against the rell and appreciated against the brin

[1 point] 8. Consider the foreign exchange market for kets, the currency of Ketterland. On which side of this market does each of the following transactions appear? I. A Ketterland importer pays a foreign supplier for machinery. II. A foreign student pays tuition to a university in Ketterland. III. A Ketterland pension fund buys shares in foreign companies.

A. I: supply of kets; II: demand for kets; III: supply of kets

B. I: demand for kets; II: supply of kets; III: demand for kets

C. I: supply of kets; II: supply of kets; III: demand for kets

D. I: demand for kets; II: demand for kets; III: supply of kets

E. I: supply of kets; II: demand for kets; III: demand for kets

[1 point] 9. The table shows the demand for and the supply of varns, the currency of Varnholm, in the foreign exchange market, with the exchange rate measured in zells (the currency of Zellmark) per varn. If the exchange rate is currently 1.6 zells per varn, the market has:

Exchange rate (zells per varn)	1.0	1.2	1.4	1.6	1.8
Quantity of varns demanded (billions)	100	90	80	70	60
Quantity of varns supplied (billions)	50	65	80	95	110

A. a shortage of 25 billion varns, and the varn will appreciate toward 1.8 zells per varn

B. a surplus of 15 billion varns, and the varn will depreciate toward 1.4 zells per varn

C. a shortage of 15 billion varns, and the varn will appreciate toward 1.8 zells per varn

D. a surplus of 10 billion varns, and the varn will depreciate toward 1.4 zells per varn

E. a surplus of 25 billion varns, and the varn will depreciate toward 1.4 zells per varn

[1 point] 10. Brannock's currency is the bran, and its main trading partner is Ulvia, whose currency is the ulv. On a correctly labeled graph of the foreign exchange market for brans, with the price of a bran in ulvs on the vertical axis, the demand curve slopes downward because, as the bran depreciates against the ulv:

A. Ulvian goods become cheaper for Brannock households, so they buy more imports
B. Brannock households need more brans to buy the same quantity of Ulvian goods
C. each bran now buys more Ulvian goods, so Ulvians want to hold more brans
D. the central bank of Brannock must buy more brans to stop the bran from falling further
E. Brannock's goods and assets become cheaper for Ulvian buyers, who buy more of them

[1 point] 11. Fennor imposes a strict quota on the number of cars its residents may import from Gavony. The exchange rate between the fen, Fennor's currency, and the gav, Gavony's currency, floats. Assuming nothing else changes, in the foreign exchange market for fens:

A. the demand for fens decreases, and the fen depreciates
B. the supply of fens decreases, and the fen appreciates
C. the supply of fens increases, and the fen depreciates
D. the demand for fens increases, and the fen appreciates
E. neither curve shifts, because a quota restricts quantities rather than prices

[1 point] 12. A strong economic expansion raises incomes in Pirrin, the main trading partner of Hestria, while incomes in Hestria do not change. Pirrin's currency is the pirr, Hestria's currency is the hest, and the exchange rate between them floats. Assuming nothing else changes, the most likely effects in the foreign exchange markets for the two currencies are:

A. the supply of hests increases and the demand for pirrs increases; the hest depreciates
B. the supply of hests decreases and the demand for pirrs decreases; the hest appreciates
C. the demand for hests decreases and the supply of pirrs decreases; the hest depreciates
D. the demand for hests increases and the supply of pirrs increases; the hest appreciates
E. there is no change in either market, because Hestria's incomes and interest rates have not changed

[1 point] 13. The government of Quillan cuts its purchases of goods and services and moves from a large budget deficit to a balanced budget, so it borrows much less. Considering only the effects that work through the loanable funds market and international capital flows, what happens to Quillan's real interest rate and to the international value of its currency, the quill?

A. The real interest rate rises, and the quill appreciates
B. The real interest rate falls, and the quill appreciates
C. The real interest rate does not change, so the value of the quill does not change
D. The real interest rate falls, and the quill depreciates
E. The real interest rate rises, and the quill depreciates

[1 point] 14. The central bank of Moravel operates with ample reserves. To fight a recession, it lowers the interest rate it pays on banks' reserve balances, and Moravel's short-term interest rates fall. Expected inflation does not change. In the short run, the most likely effects on the international value of Moravel's currency, the mor, and on Moravel's net exports are:

A. the mor appreciates, and net exports decrease
B. the mor appreciates, and net exports increase
C. the mor depreciates, and net exports increase
D. the mor depreciates, and net exports decrease
E. neither changes, because an ample-reserves policy affects only bank reserves

[1 point] 15. After Ostrand's currency, the ost, depreciates against the currencies of all its trading partners, Ostrand's exports rise from 180 billion to 205 billion osts a year and its imports fall from 240 billion to 225 billion osts a year. Ostrand's marginal propensity to consume is 0.75. Assuming a constant price level, the change in net exports shifts Ostrand's aggregate demand curve:

A. to the right by 40 billion osts
B. to the right by 100 billion osts
C. to the right by 120 billion osts
D. to the right by 160 billion osts
E. to the right by 200 billion osts

[1 point] 16. Torvia's economy has an inflationary gap. Torvia's currency, the torv, then appreciates sharply against the currencies of its trading partners. Considering only the effect that works through net exports, in the short run:

A. net exports decrease, aggregate demand shifts left and the inflationary gap narrows
B. net exports increase, aggregate demand shifts right and the inflationary gap widens
C. net exports decrease, aggregate demand shifts left and the inflationary gap widens
D. net exports increase, aggregate demand shifts right and the inflationary gap narrows
E. nothing changes in the short run, because exchange rates affect only long-run aggregate supply

[1 point] 17. Kalmor's currency, the kal, depreciates by 30 percent against all other currencies. Which of the following groups in Kalmor is most likely to be made better off?

A. Kalmorian families planning holidays abroad
B. Kalmorian manufacturers that depend on imported parts
C. Kalmorian hotels and resorts whose guests are mostly foreign tourists
D. Kalmorian shops that sell imported electronics
E. Kalmorian firms repaying loans that must be repaid in foreign currency

[1 point] 18. A hit film set in Wendmark sets off a lasting boom in visits by foreign tourists. Wendmark's currency, the wend, floats against all other currencies. Assuming nothing else changes, what happens to the international value of the wend and to Wendmark's exports of manufactured goods?

A. The wend depreciates, and manufactured exports rise
B. The wend appreciates, and manufactured exports fall
C. The wend appreciates, and manufactured exports do not change
D. The value of the wend does not change, and manufactured exports do not change
E. The wend depreciates, and manufactured exports do not change

[1 point] 19. After Ashlund strengthens the legal protection of investors, foreign purchases of Ashlund's financial assets rise by 30 billion lunds a year, and Ashlund residents' purchases of foreign financial assets fall by 10 billion lunds a year. The lund, Ashlund's currency, floats, and Ashlund's central bank makes no official reserve transactions. If nothing else in the capital and financial account changes, how do Ashlund's capital and financial account balance and its current account balance change?

A. Capital and financial account: rises by 40 billion lunds; current account: falls by 40 billion lunds
B. Capital and financial account: rises by 40 billion lunds; current account: does not change
C. Capital and financial account: rises by 20 billion lunds; current account: falls by 20 billion lunds
D. Capital and financial account: rises by 30 billion lunds; current account: does not change
E. Capital and financial account: falls by 40 billion lunds; current account: rises by 40 billion lunds

[1 point] 20. Delmora's government increases its purchases of goods and services and finances them entirely by borrowing. At the same time, Delmora's central bank, which operates with limited reserves, sells government bonds on the open market. Expected inflation does not change in the short run. Considering only the effects that work through interest rates and the foreign exchange market, what happens in the short run to Delmora's real interest rate, the international value of its currency (the del) and Delmora's net exports?

A. The real interest rate rises, the del depreciates and net exports increase
B. The real interest rate rises, the del appreciates and net exports decrease
C. The real interest rate falls, the del depreciates and net exports increase
D. The real interest rate does not change, because the two policies offset each other, so neither the del nor net exports change
E. The changes in the real interest rate, the del and net exports are all indeterminate without knowing the size of each policy

Short Answer (1 question)

[10 points] 21. Balance of payments, exchange rates and capital flows. Ardenia and Velmar trade goods, services and financial assets freely. Ardenia's currency is the ardo, Velmar's currency is the vel, and the exchange rate between them floats. The table shows Ardenia's international transactions last year, in billions of ardos. This year, the nominal interest rate is 6 percent in Ardenia and 5 percent in Velmar, and expected inflation is 4 percent in Ardenia and 1 percent in Velmar.

Ardenia, last year	Billions of ardos
Exports of goods and services	420
Imports of goods and services	465
Net income from abroad	15
Net unilateral transfers	−8
Purchases of Ardenian financial assets by foreigners	110

[2 points] (a) (i) Calculate Ardenia's current account balance last year, and state whether it is a surplus or a deficit. Show your work. (ii) Assume that Ardenia's central bank made no official reserve transactions last year and that the only entries in Ardenia's capital and financial account were foreign purchases of Ardenian financial assets and Ardenian purchases of foreign financial assets. Calculate the value of Ardenian residents' purchases of foreign financial assets last year. Show your work.

[2 points] (b) Using this year's interest-rate and expected-inflation data given above, will financial capital flow from Ardenia to Velmar or from Velmar to Ardenia? Show your work and explain.

[2 points] (c) Draw a correctly labeled graph of the foreign exchange market for the ardo, and label the equilibrium exchange rate before the capital flow E_1. Show the effect of the capital flow you identified in (b), and label the new equilibrium exchange rate E_2.

[2 points] (d) Considering only the change in the exchange rate that you showed in (c): (i) What happens to Ardenia's net exports? Explain. (ii) What happens to Ardenia's aggregate demand and real GDP in the short run?

[2 points] (e) (i) Draw a correctly labeled graph of the loanable funds market in Ardenia, and show the effect of the capital flow you identified in (b) on Ardenia's real interest rate. (ii) What happens to private investment spending in Ardenia? Explain.

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