Selected Exam Problems

Problem 6, Midterm 2

Consider Norway, a country for whom oil accounts for around 58% of its exports.\(^1\) From 2004 to 2005, the global price of oil increased from 38\$ a barrel to 54\$ a barrel. In the following analysis, let’s think of Norway as a country that exclusively exports oil and imports all other goods, whose prices have not changed. To further simplify our analysis let’s assume that there is one world currency, Norway is considered a small open economy, and the labor supply only responds to the interest rate, and not other substitution or wealth effects. Finally, for ease of exposition assume that Norway starts with a balanced current account (CA = 0).

a. What happened to Norway’s terms of trade over this period?

b. Suppose that individuals in Norway consider the increase in oil prices to be permanent. What happens to:
   i. aggregate supply
   ii. consumption demand
   iii. aggregate savings
   iv. investment demand
   v. the real interest rate
   vi. and the current account

   Be sure to provide an explanation for i.-vi.

c. Graph your answer to b.

d. Looking at the data, Norway’s current account balance actually went in the opposite direction of what you put for part b.vi.\(^2\) What, if anything, does this imply about Norwegian expectations about the persistence of the oil price increase?

e. Suppose that in 2003 Norway had a current account surplus. Does this necessarily imply that Norwegian households were net savers? Why or why not?

Problem 3, Part d, Final Exam

In the midst of Venezuela’s economic crisis, the Central Bank has confirmed that over the last year its money supply has increased by 200%\(^3\), while estimates of the inflation rate over a similar time period were 800%.\(^4\) What could explain the disparity between the money supply growth rate and the inflation rate?

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\(^1\) In 2015. Source: http://atlas.media.mit.edu/en/profile/country/nor/
\(^2\) Source: http://www.indexmundi.com/norway/current_account_balance.html
\(^3\) Source: http://www.reuters.com/article/us-venezuela-economy-idUSKBN1751ZE