This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be Thursday, 12/02, at 7:00, in the normal room (I hope).

Chapter 12, starting at page 281: Understand what the multiplier, a.k.a. the autonomous expenditure multiplier, a.k.a. the government spending multiplier, is and the process that causes it to be greater than 1. Do not worry about the specific formula because it will change when investment, taxes, and/or imports become functions of income. Know how to derive the AD curve from the 45° diagram, a.k.a. the Keynesian cross diagram. Why do price changes effect the multiplier?

Chapter 13: What is fiscal policy? What should the government do with taxes and spending if there is an inflationary gap or a recessionary gap? Show those actions on the LRAS/SRAS/AD diagram. What are the drawbacks of doing fiscal policy, for example, crowding out investment and lags? Why are these problems? What is the Laffer Curve and why does it matter? What is Ricardian Equivalence and why should it hold? Note that Ricardian Equivalence, the size of crowding out and lags are often debated among economists. What are automatic stabilizers? What determines the size of the government deficit/surplus? Why should we know the unemployment rate when considering the desirability or lack of desirability of the deficit? How does a deficit differ from the debt? Ignore the appendix, except that it can help you understand the chapter.

Chapter 14: Why should money be a good medium of exchange, unit of account, store of value, and standard of deferred payment? What is meant by liquidity? What backs our money? Know what is in M1, M2, but not M3. You only have to know the items in them that the book mentions. (There are other parts of M2 and M3 that the book leaves out.) Know the properties of each item in them. Know what happens when we move money between them. Hints: Do not forget that M1 is in M2. Unless you are taking a loan, then M2 doesn't change. What is financial intermediation? Do not worry about adverse selection and moral hazard. Do not worry about what each organization in Table 14-2 does. Ignore pages 333 - 336. What is the Federal Reserve? What does it do? What are its tools? How do they affect the money supply? (That is covered in more detail in chapters 15 and 16.) The map on page 338 incorrectly has us in the Richmond district. We are in the Cleveland district.

Chapter 15: What are reserves? How do we calculate required reserves? It's 10% of <u>checkable deposits, a.k.a., demand deposits</u>. What goes on each side of the balance sheet of a bank? What are open market operations and how do they affect the balance sheet of the bank? Ignore the balance sheet of the Fed. How does the money supply change? What is the reason the money can grow 10 times the original bond purchase? What is the formula for the money multiplier? Why is it too large? How does the discount rate affect the money multiplier? **Note that if I ask about "the multiplier"**

it is the autonomous expenditure multiplier I will be referring to. If I mean the money multiplier, then I will specify it. What does the FDIC do? How does FDIC affect a bank's willingness to make risky loans?

This is the non-graded assignment #8A that will be gone over with assignment #8.

1) (15 points) Why is the money multiplier greater than one? In other words, how can the Fed's buying of a $1000 bond ultimately lead to more than $1000 increase in the money supply?

2) (20 points) Use the balance sheet to the right to answer this question. What number should replace the "?" in "other" on the balance sheet? How much are the bank's excess reserves? How much would the money supply increase if they loaned out all they could and the money multiplier worked to its full extent? Briefly explain your answers.

Assets		Liabilities and Net Worth	
Cash	100	Demand deposits	2000
Deposits at Fed.	150	Savings accounts	1000
Loans	3000	Loans	0
Bonds	500	Other	?
Other	250	Equity	800

3) (15 points each) Illustrate the following events on the balance sheet for a bank. Briefly explain how you got the entries.

A) The Fed buys a $100 bond from the bank.

B) The bank loans $500 to a customer.

C) The bank borrows $50 from the Fed.

4) (20 points) When we calculated the money multiplier, we assumed that the money is redeposited in the bank. What would happen to the size of the money multiplier if that assumption was relaxed? Explain your logic.