This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have inadvertently overlooked something. 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 on 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.

There is no review session for this test. I will be available in my office from 7:00 until 8:30 on Monday 10/24 if you have questions. Note, I decided to include section 18.4 on this test.

Chapter 16: Understand how the balance of payments adjusts with flexible exchange rates. Know how to derive the supply and demand for foreign exchange from the supply and demand for imports and exports. Note that the demand for imported goods will result in a demand of the country's currency and a supply of the home currency. How do exchange rate changes affect the domestic income and prices? What is the *Dutch Disease*? (We are not talking about elms. It is where your economy grows so much that the terms of trade turn against your exports and your economy is hurt.) Be able to tell if the exchange rate will be stable or unstable by looking at a graph and with the Marshall-Lerner condition. Understand why the economics of why Marshall-Lerner condition holds. What is meant by elasticity pessimism and the identification problem. What is the J-curve and how can the Marshall-Lerner condition be used to explain it? How do the economies adjust to improperly set exchange rates under the gold standard? Ignore the appendix; however, section A16.3 is easily understood and may help you to understand part of the chapter better.

Chapter 17: This chapter does not do a good job explaining the Keynesian model. It is best to just simplify it to the 45° diagram, a.k.a. Keynesian cross diagram, and ignore the S = I. However, when you do the moving line on the diagram, label it E = C + I + G + X - M. That line moves whenever any of those five variables change, unless that change is caused by a change in income. Note that most movements are parallel movements unless something marginal changes. That is because marginal in this context is Δsomething/ΔY. That is the definition of part of the slope of that line. Therefore, marginal things affect the slope. Increases in demand for any of the five variables will move the curve upwards. Do not worry about the mathematics of the various multipliers. Understand why the multiplier is smaller when we have an open economy than when it is closed, and know how to explain other similar scenarios. For example, be able to explain why when we are a big country, an increase in our exports will have a different effect than an increase in our investment, and why both of those are different from an increase in foreign investment. What causes the monetary adjustments and the automatic adjustments? Skip the appendix.

Chapter 18 up to **18.4**: Understand the Swan diagram and why each zone has the disequilibrium that is listed. Why do the IS, LM, and BP lines slope as drawn in the book? Understand how monetary and fiscal policies move the lines for both when the BP line is flatter than the LM line and when it is steeper, but only for fixed exchange rates. Why does the BP become horizontal when there is perfect capital mobility? For the graph of internal and external balance under fiscal policy and monetary policy, know how to determine where there is inflation, unemployment, external deficit, and internal deficit.

Non-graded assignment #6A to be covered with assignment #6.

1A) (20 points) Draw a Swan diagram and put a point that is a little bit to the left of due up from the equilibrium point, but to the right of the YY line. What are the internal and external problems with this point? Explain your logic.
1B) (10 points) Which direction will the economy start to move from that point? Explain your logic.

2) (30 points) Draw the IS/LM/BP diagram with fixed exchange rates, inelastic capital flows, and the initial equilibrium to the left of full employment and a trade deficit. Draw the necessary monetary and fiscal policy to achieve full employment. Explain why the curve(s) moved as drawn.

3) (10 points) Explain why the BP curve slopes up.

4) (30 points) Draw the IS/LM/BP diagram with fixed exchange rates, perfectly elastic capital flows, and the initial equilibrium to the right of full employment and a trade surplus. Draw the necessary monetary and fiscal policy to achieve full employment. Explain why the curve(s) moved as drawn.