Wilfrid W. Csaplar Jr. Principles of Macroeconomics Review Sheet for Exam 4

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have inadvertently 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 have you recite them. I will probably ask one of the questions from the workbook.

The optional review session for this test will be Thursday 05/01 at 7:00 in the normal room, assuming it is available. I will announce the room later.

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 Ricardian Equivalence and why should it hold? Note that Ricardian Equivalence and the size of crowding out and lags are often debated among economists. What is the Laffer Curve and why does it matter? What are automatic stabilizers? What determines the size of the government deficit/surplus? How does a deficit differ from the debt? Ignore the appendix.

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? Know what is in M1 and M2. Do not worry about M3. I just mentioned it to help you realize that more is going on than we are covering. 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 making a loan, then M2 doesn't change unless we include M3. What is financial intermediation? Do not worry about what each organization in Table 14-2 does. Ignore pages 339 - 341. 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 chapter 15.)

Chapter 15: What are reserves? How do we calculate required reserves? It's 10% of checkable deposits, a.k.a., demand deposits. 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 and the Fed? Note that the only assets we mentioned for the Fed were bonds and their only liability was bank deposits. How does the money supply change? What is the reason the money grows 10 times the original bond purchase? What is the formula for the multiplier? 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. Ignore pages 367 - 372. What does the FDIC do? What are adverse selection and moral hazard?

Chapter 17 will be on both parts of the final, but not exam #4: What determines the transactions, precautionary, and asset demands for money? Be able to draw the MS/MD diagram and move it around. Be able to show monetary policy on the LRAS/SRAS/AD too. Know the foreign exchange effect. Why can't the government control both MS and i at the same time? (That was hard to type because the computer kept changing the i to I.) Understand why MV=PY and what the implications of that equation are for monetary policy?

Nongraded assignment #8A to be reviewed with assignment #8

1A) (25 points) If the Fed buys a $100 bond from a bank, how can that eventually result in an increase of the money supply of more than $100? Given the assumptions we made in class, how much will the money supply increase? How did you get that number?

1B) (20 points) The money multiplier process assumes that banks loan out all of their excess reserves. Why might they not do that? How would that affect the money multiplier?

2) (15 points) What is the precautionary demand for money? What will change it? Why?

4) (15 points) How does an increase in the discount rate affect the money supply? Why does it have that effect?

5) (15 points) When I started teaching, the required reserve ratio was 12%. What did lowering it to 10% do to the money supply? Why?