Wilfrid W. Csaplar Jr. Intermediate Macroeconomics Review Sheet for Exam 1

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 Wednesday, 2/15, at 7:00, in Old Main 109 because there is a class in the normal room. (I hope that room will be open.) (This is the same time as the previous one because of SGA.)

You will be given a pair of equations and asked to explain one of them.

Chapter 5: What is the current account (CA)? How is it calculated? What are the capital account (KA), financial account (FA) and the capital financial account (KFA)? Why should the CA + KFA = 0? How do NFP and unilateral transfers enter the equation? Note that the summary on page 182 does a great job of showing how all the terms relate to each other. Why does $S^d = I^d + CA$ or more easily put $S^d + KFA = I^d$? Be able to manipulate the S/I diagram for both small and large open economies. Be able to show what moves the curves, and know how to find a CA deficit or a KFA deficit. Know how government policy and shocks affect the diagram. How are the twin deficits related?

Chapter 6: What causes economic growth? How do we measure A? For the Solow Growth Model, be able to draw the per-worker production function. Understand what moves it. How do we find k_G (the "golden rule" capital-labor ratio), k_{max} (the maximum capital-labor ratio), and k^* (the equilibrium capital-labor ratio)? Why is the latter at the point where $sf(k)$ crosses $(n+d)k$? What moves those two lines? Why does the economy automatically move towards k^* and why is that not necessarily at k_G? Understand the economic reasons for the changes in k that the diagram predicts. For endogenous growth theory, understand why they assume $Y=AK$ and why $\Delta Y/Y = sA - d$. What government polices affect "s," "A," and "d"? (Nothing the government does really affects d.) Why do they have those effects? (They can be seen on pages 238 - 240.) For this chapter, it is crucial that you remember the differences between small and CAPITAL letters. Remember that small letters are rates, ratios, or fractions. Do NOT use them interchangeably with capital letters.

Chapter 7: What are the three functions of money? What are in M1, M2, and M3? Why do we have more than one definition of money? How does the central bank affect the money supply? What determines which type of assets you want? (Expected return, risk, and liquidity) What determines the demand for money? (Price level, real income, interest rates, wealth, and the properties of other assets.) The summary on page 257 should be a big help. What is the quantity theory of money? Why should the velocity of money be constant? Why hasn't M1's velocity been constant? Why is the inflation rate dependent upon the growth of money and the growth of GDP

This is the non-graded assignment #6A that will be gone over with assignment #6.

1) (20 points) Explain $M^d = P*L(Y, r + \pi^e)$.

2) (20 points) Why has the velocity of M1 increased and become unstable in the past 40 years? Why hasn't that affected the velocity of M2?

3) (15 points) Which definition of money, M1, M2, or M3, should best fit our theories as to how the money supply affects the GDP? Explain your logic.

4) (5 points each) For each event, determine what happens to M1, M2, and M3. Explain your logic.
A) You take $1000 from your CD and put it into your checking account.
B) You charge $500 on a credit card to pay for your books.
C) You pay for a $10 pizza with a check.
D) You move $120,000 from one CD to two equally sized CDs.
E) You take $100 cash from your savings account.

5) (20 points) Suppose that bonds became more liquid. What would that do to the demand for money? Why? What would happen to the demand for money if the expected inflation rate increased? Why?