

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's time will be announced, probably in the computer lab on 3/28.

For the laboratories, be able to run regressions. Understand what **Adjusted  $R^2$** , **Significance of F**, **coefficient**, **T-statistic**, **P-value**, **upper** and **lower 95%** mean. What are good values for those numbers? Be able to know when to eliminate a variable from a regression based upon those statistics. Know how to run a regression based on time. Be able to use those results to write an equation which will predict your  $Y$  variable. Be able to check for **multi-collinearity** using the correlation coefficients with a cutoff of 0.80, check for **auto-correlation** and **heteroscedasticity** using the residual plots. For the former two, be able to do the simple corrections of eliminating a variable and using a squared term or  $\ln$  respectively. *Note that if you use  $\ln$ , you must do  $\ln$  for all variables.* Know the formal test for heteroscedasticity using the **F-distribution**.

Chapter 11: What is meant by **real-wage rigidity** and **nominal wage rigidity**? Which one is the important one? Be able to explain it with the following explanations, and be able to explain the problems with them. How does **the high wage reduce turnover** and/or increase efficiency? Why does the **effort curve** take that shape and why do you want the point of tangency? How does the **efficiency wage** cause high unemployment? What does it do to the FE line? How do **menu costs** and **imperfect competition** cause high sticky prices? For the latter, we mentioned that the firms will not lose all of their customers if they do not respond to the market, the possible assumption that their competitors may only meeting price decreases, and **fixed markup**. For the latter, explain why a fixed markup may make economic sense. The **effective labor demand curve** because it is just an inverted production function. How do monetary and **fiscal policies** affect the IS/LM/FE and SRAS/LRAS/AD diagrams? For the explanation of the IS curve movements, you can use the ones in the book, but the comparing it to the AD diagram is mathematically equivalent and easier to understand, especially in this chapter. What causes the business cycle in the **Neo-Keynesian view**? Why might this require government intervention? What is the **liquidity trap** and why does that mean monetary policy cannot work? How do supply shocks affect the economy?

Chapter 12: Understand the theory using the LRAS/SRAS/AD diagram which would result in a nice **Short-Run Phillips Curve (SRPC)**. Understand what moves the **Augmented SRPC** and the **LRPC**. Note that the intersection point is only the point where we will be if we are at full employment. Therefore, if we do not have  $\pi = \pi^e$ , then the economy will not be at that point. The point the economy is at depends upon the relationship between  $\pi$  and  $\pi^e$ . What are the costs of unemployment? Understand both the **cultural** and the **hysteresis** explanations of what determines the natural rate of unemployment. The latter is the **insider-outsider model**. What can be done to reduce the natural rate of unemployment? What are the problems with **anticipated inflation**, **unanticipated inflation**, and **hyperinflation**? How can inflation be fought? What are the advantages and disadvantages of **cold turkey** versus **gradualism**? Why aren't **wage and price controls** a good idea? How can **tax-based income policies (TIP)** help

reduce inflation? Why might they make the problem worse?

Chapter 13 until Page 500: Know how to interpret changes in the **nominal exchange rate** to determine if a currency has **appreciated, depreciated, revalued, or devalued**. Be able to calculate the **real exchange rate**. Hint: the exchange rate is the price of the \$, so it is the other currency per dollar. When calculating the real exchange rate, make sure the units of currency cancel. So do not multiply C\$/US\$ by C\$/Q because the C\$ will not cancel. What should the nominal exchange rate be when using **PPP**? Ignore the J-Curve. Be able to use the **supply and demand for foreign exchange** to determine the nominal exchange rate. *Hint: The reason for demanding a currency or supplying a currency is to buy something – goods and services or stocks and bonds – which are in a foreign currency. Therefore, most events will affect both countries in a similar manner. Thus, most events will move both supply and demand.* I will only ask about changes in foreign or domestic values of the following variables: prices, interest rates, and GDP. How do changes in the exchange rate affect the IS/LM/FE diagram? You can use the book's explanation, or you can use the Keynesian Cross explanation.

---

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

- 1) (20 points each) Illustrate the following events on the supply and demand for the US\$ compared to the Euro (€). Explain why the curve(s) moved as drawn. Which country's currency appreciated? How can you tell?
  - A) The CPI in France increases.
  - B) The interest rates in USA increases.
  - C) The French GDP falls.
- 2) (10 points) Suppose the exchange rate between the US\$ and the Japanese yen is  $110\text{¥}/\text{US\$}$  and the market changes it to  $\text{US\$}0.01/\text{¥}$ . Did the US\$ appreciate, depreciate, revalue, or devalue? Explain your logic.
- 3) (10 points) If the nominal exchange rate is  $\text{£}0.7/\text{\$}$ , the price level in Great Britain is  $\text{£}140/Q_{\text{GB}}$ , and the price level in the USA is  $\text{\$}200/Q_{\text{US}}$ , then what is the real exchange rate? Show all work.
- 4) (20 points) What is meant by absolute PPP? Why should it hold? Why might it not hold?