

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 TBA on Wednesday, 3/29.

Prof. Honsowetz will give you the exam.

Note, last year the labs and some of the course work were Exam #2.

For the laboratories, be able to run regressions. Understand what **Adjusted R²**, **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.

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 π and π^e . What are the costs of unemployment? Understand both the **cultural** and the **hysteresis** explanations of what determines the natural rate of unemployment, a.k.a. the unemployment rate at full employment. 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 up to Page 517: 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**? What is 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. Understand how fiscal and monetary policies affect the IS/LM/FE diagram for a flexible exchange rate. Understand how our policies affect the foreign country.

This is the non-graded assignment #7A that will be gone over with assignment #7.

1) (10 points) Suppose that at the start of the month, the exchange rate between the euro (€) and the dollar was €1.5/\$ and at the end of the month, the exchange rate was \$1.5/€. Did the dollar appreciate, depreciate, revalue, or devalue? Explain your logic and show all work.

2) (20 points) Draw the J-Curve and explain why it takes its shape.

3) (20 points each) Answer each part with separate graphs and separate paragraphs. Draw the S/D for the dollar with the British pound, £, as the other currency. Illustrate the effects of the following events on the graph. Explain why the curve(s) moved as drawn. Which currency appreciated? State how you reached that conclusion.

A) The Fed raised interest rates on 3/22.

<https://www.npr.org/2023/03/22/1165274305/the-fed-raises-interest-rates-again-despite-the-stress-hitting-the-banking-system>

B) Inflation in the UK unexpectedly jumped up last month.

<https://www.cnbc.com/2023/03/22/uk-inflation-rate-breaks-3-month-stretch-of-declines-with-surprise-rise-to-10point4percent.html>

4) (30 points) Draw the Keynesian IS/LM/FE diagrams for the USA and for Canada. Illustrate the effects of an increase in our government spending. Explain why the curves moved as drawn.