Wilfrid W. Csaplar Jr. Principles of Macroeconomics
Review Sheet for Exam 4 & HW #8A Review Sheet for the Two Parts of the Final.

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may 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. I am more likely to ask questions that make you use definitions rather than have you recite them.

The optional review session for test 4 will be Tuesday 4/20, at 7:00 in a room to be announced. The review session for the first part of the final will be Thursday 4/29, at a time and in a room to be announced.

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 the Laffer Curve and why does it matter? What is Ricardian Equivalence and why should it hold? Note that Ricardian Equivalence, the size of crowding out and lags are often debated among economists. What are automatic stabilizers? What determines the size of the government deficit/surplus? Why should we know the unemployment rate when considering the desirability or lack of desirability of the deficit? How does a deficit differ from the debt? Ignore the appendix, except that it can help you understand the chapter.

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? What backs our money? Know what is in M1, M2, but not M3. You only have to know the items in them that the book mentions. (There are other parts of M2 and M3 that the book leaves out.) 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. What is financial intermediation? What are adverse selection and moral hazard? Do not worry about what each organization in Table 14-2 does. Ignore pages 333 - 336. 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 chapters 15 and 16.) The map on page 338 incorrectly has us in the Richmond district. We are in the Cleveland district.

Chapter 15: What are reserves? How do we calculate required reserves? It's 10% of <u>checkable deposits, a.k.a., demand deposits</u>. 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? Ignore the balance sheet of the Fed. How does the money supply change? What is the reason the money can grow 10 times the original bond purchase? What is the formula for the money multiplier? Why is it too large? 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.** What does the FDIC do? How does moral hazard affect the FDIC?

Wilf Csaplar Jr. Economics 162 Homework #8A To be covered on 4/19

This is a non-graded homework assignment that will be covered during the class when we cover assignment #8. The purpose of this assignment is to give you sample questions for the material we covered after you handed in homework #8. This material will be on the exam.

1) (25 points) Give an example of *moral hazard* in the banking industry. Be very specific in your explanation of how that is *moral hazard*.

2) (25 points) On a bank balance sheet, illustrate the bank loaning out $10 of excess reserves. Explain your entries. What happened to the money supply? Explain your logic.

3) (25 points) Explain how an increase in the *Federal Funds Rate* will cause a change in the money supply.

4) Use the balance sheet to the right to answer these questions. Explain your answers to all parts.
A) (5 points) How much should be in the missing entry?
B) (10 points) How much excess reserves does this bank have? If they loaned out the full amount, and the money multiplier worked to its fullest extent, then what would be the ultimate change in the money supply?
C) (10 points) What type of loans are the loans on the right-hand side?

Assets	Bank A	Liabilities & NW	
Cash	20	Checking deposits	360
Deposits at Fed	40	Savings deposits	140
Bonds	440	Loans	100
Loans	1000	Misc.	?
Misc.	200	Equity	920

Review Sheet for the two parts of the final.
The two parts of the final will be in the same order as last semester, which is the opposite order of the first two semesters. The second half of the final will be just like the second half of the final for the last semester. It will be the same except you will have different numbers. If I were you, I would use a Keynesian, but not extreme Keynesian, approach to solve the problem because it is easier to solve problems in a Keynesian world. (That does not mean that Keynes is right, just easier to deal with.) Chapter 17, up to page 405 will be helpful even though we will not cover it directly.

The first part of the final will be held the last day of class. It will cover the material that is not directly covered by the second half of the final. For example, I will not ask you to show an increase in the money supply on the LRAS/SRAS/AD diagram. Anything on any review sheet that is not explicitly covered in part 2 of the final is fair game. For example, question #1 above, could be on the first half of the final, but question #1 in the second group of questions will not be in part 1 of the final.

When I write the final, I look to see what I did not ask about, and what were the major topics. I write questions about those topics. (Obviously, opportunity costs and supply/demand will be on the first half of the final.) I try to get the questions evenly distributed from all the tests. However, the second half of the final covers much of the material for tests 3 and 4 with some of test 2. Therefore, most of the material for the first half of the final will be on material from tests 1 and 2, with some questions from the other material covered.

Chapter 16: What determines the demand for money? What are transaction, precautionary, and asset demand for money? Be able to move the MS and MD curves. Ignore the S/D for bonds. Illustrate the effects of monetary policy on LRAS/SRAS/AD diagram. Understand why MV=PY. Understand why monetarists do not like monetary policy. (This is the lags from chapter 13 again, but they are of different lengths than they were there.) Why can’t the Fed choose to set both interest rates and the money supply?

Non-graded assignment based upon chapter 16.

1) (25 points) Illustrate an increase in the money supply on the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn.

2) (25 points each) Illustrate the following events on the supply and demand for money. Explain why the curve(s) moved as drawn.
A) The GDP increases.
B) The money supply increases.

3) (25 points) Use the supply and demand for money to explain why no central bank can control both interest rates and the money supply. (Of interest, if the central bank wants to control the exchange rate, then it cannot control either the interest rates or the money supply.)