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 Thursday, 3/4, at **8:00**, in the normal room.

There will be a question which will require you to explain one of two equations.

Chapter 5: What is money? What does neutrality of money mean? What are its four functions? How is *standard of measure* (a.k.a. unit of account) different from *medium of exchange*? What is in M1, M2, and M3? Note that I will only require items mentioned in class because for the purposes of macroeconomics, they are the ones that affect the economy. (If I was teaching money and banking, I would hold you responsible for all of them.) Since Keynes has two money demand curves, the liquidity preference and the demand for loanable funds, and since the book says that both determine the demand for money, I will be using the one with the vertical MS curve as discussed in class. So either explanation for the movement of the curves is acceptable. Note how the price of bonds and the interest rate are inversely related, and that the supply of loanable funds is the demand for bonds. How do interest rates affect I, C, X, and M? For the latter, know how it affects the supply and demand for foreign exchange, but you do not need to know that graph.

Chapter 6: For the IS curve, you can derive it the way the book does in the equations (S = I), or since it is mathematically the same thing, you can derive it by using the Keynesian Cross (45° diagram). Note that it shows equilibrium in the goods and services market, so anything that moves the Keynesian Cross (45° diagram) will also move the IS curve except for interest rates. For the LM curve, it comes from our combined MD curve, so do not worry about it rotating. Rather, just move it. Anything that moves MS curve or MD curve, except GDP, will move the LM curve. Know when the IS/LM diagrams are flat or steep and why they take that slope. Know how to use the IS/LM diagram with the MS/MD diagram, AS/AD diagram, MS/MD, and the Keynesian Cross (45° diagram) to show how different events affect the different components of the economy. When using multiple graphs with the same variable on the axis, make sure that variable changes in the same direction on all graphs with that variable on the axis. Use the IS/LM diagram to derive the AD curve. Ignore the *Pigou Effect* when drawing the diagrams, but know why we ignore it. Know how to show both monetary and fiscal policy on the IS/LM diagram. Equation 6-17 should not have M in it.

Chapter 7: What determines the level of consumption? How does that relate to the savings function? How can the MPS be constant while the APS rises? About how large are the MPC and MPS? What is meant by unplanned inventory change (a.k.a. unplanned inventory investment)? Why does it occur? Do not worry about the S/I diagram. What is the multiplier and why is it so large? What the book normally calls the investment multiplier is better thought of as the autonomous expenditure multiplier because it applies to any autonomous expenditure. Since the one most commonly talked about is government spending, many books call it the government spending multiplier. Know how to derive it from a set of equations. **Hint:** It is helpful to leave G as G rather than substitute a number for it because then the number in front of G at the end is the multiplier. Note that I will not give the same equations as done in class or can be found in the book. Therefore, learn the method of solving it. How does it relate to the slope of the IS curve?

This is the non-graded assignment #4A that will be gone over with assignment #4.

1) (50 points) Illustrate an increase in the Canadian GDP on the IS/LM, MS/MD, AS/AD, and Keynesian Cross diagrams for the USA. Explain why the curves moved as drawn.

2) (30 points) Suppose that investment is sensitive to interest rates and MD is insensitive to interest rates. Draw the IS/LM diagram for this situation. Explain why the curves take those shapes. Illustrate an increase in government spending on the diagram. Explain why the curve(s) moved as drawn. Was the fiscal policy effective? If yes, then why did it work well? If no, then why didn't GDP change?

3) (20 points) Why is the MPC less than the APC?