

Eco202 Review, April 2009, Prof. Bill Even

I. Chapter 4: Introduction.

- A. *Economic growth*
- B. *Real versus nominal GDP*
- C. *Potential GDP*
- D. *4 stages of business cycle*
- E. *Lucas Wedge*
- F. *Okun gap*
- G. *Determinants of economic growth*
- H. *Labor force statistics*
 - 1. Unemployment rate
 - 2. Labor force participation rate
 - 3. Employment population ratio

II. Chapter 5: Measuring GDP and economic growth

- A. *GDP*
 - 1. Definition
 - 2. Circular flow and link between income & expenditure approach to measuring GDP.
 - 3. $S+T = I + G + (X-M)$
- B. *Stocks versus flows*
 - 1. Wealth and savings
 - 2. Capital, gross and net investment and depreciation.
- C. *Real vs nominal (money) GDP*
 - 1. GDP deflator
 - a) Calculation
 - b) interpretation
 - 2. Chain-weighted method for real GDP.
- D. *Real GDP as a measure of economic welfare.*

III. Chapter 6: Monitoring cycles, jobs and the price level.

- A. *Labor force stats*
 - 1. Unemployment rate
 - 2. Employment-population ratio
 - 3. Labor force participation rate.
- B. *Pro- and counter-cyclical variables.*
- C. *Types of unemployment*
 - 1. Frictional

2. Structural
 3. Cyclical
- D. *Natural rate of unemployment***
1. Definition
 2. Source of changes over time.
 3. Relationship between unemployment rate & potential GDP.
- E. *Consumer Price Index.***
1. Calculation
 2. Use for conversion of nominal to real variables
 3. Use for calculating inflation rates.
 4. Bias in CPI

IV. Ch.7: The classical model.

- A. *Real versus nominal variables.***
- B. *Components of the classical model***
1. Labor market
 - a) Factors affecting supply
 - b) Factors affecting demand
 2. Production function.
 - a) Factors shifting production function.
 3. Analyze the effect of a change in labor supply, labor demand, or production function on real wage, employment, potential GDP, productivity.
- C. *Loanable funds market***
1. Factors affecting supply
 2. Factors affecting demand
 3. Impact of a change in supply or demand on real interest rate, private investment.

V. Chapter 9: Money, the price level, and inflation.

- A. *Money***
1. Definition
 2. Types of money
 3. Functions of money
- B. *Gresham's law***
- C. *Banking***
1. Bank objectives
 2. Trade-off between risk, return and liquidity
 3. Fractional reserve banking
- D. *Structure of Federal Reserve***

1. Board of governors.
 2. FOMC
 3. Regional banks.
- E. Components of money supply**
1. Reserves
 2. Monetary Base
 3. M1, M2
- F. Creation of money by bankings system and deposit multiplier.**
- G. Fed tools and control over money supply.**
- H. Effect of following on money supply, loans and interest rates.**
1. Fed open market purchase or sale.
 2. Fed changes reserve ratio
 3. Fed changes discount rate
 4. Public holds more or less wealth as cash outside bank.
- I. Money supply/demand and interest rates.**

VI. Financial markets.

- A. Bonds**
1. Present value
 2. Relationship between price and yield
 3. Calculating yields
 - a) One year bond
 - b) Zero coupon bond
 4. Yield curve and expectations about future interest rates.
- B. Stocks**
1. Fundamental value.
 2. Price-earnings ratio
 3. Beta

VII. Ch. 10: Exchange rate and balance of payments.

- A. Foreign exchange market**
1. Supply of \$
 2. Demand for \$
 3. Factors changing supply or demand for \$ and impact on value of \$
 4. Effect of appreciation or depreciation of \$ on U.S. exports and imports.

- B. *Interest rate parity***
 - 1. Effect of exchange rate movements on net return in foreign assets.
 - 2. Link between interest rate differentials and expected changes in exchange rates.
- C. *Purchasing power parity***
 - 1. Opportunities for “arbitrage”
 - 2. Link between inflation differentials and exchange rate movements.
- D. *Balance of payments accounts.***
 - 1. Current Account
 - 2. Capital account
 - 3. Official settlements account.
 - 4. Bal of payments and lender/borrower status; debtor creditor status.
- E. $NX=(T-G) + (S-I)$**
- F. *Exchange rate policies.***
 - 1. Fixed exchange rates and intervention required to support under- or over-valued currency.
 - 2. Flexible exchange rates.
 - 3. Crawling peg

VIII. Ch. 11: Aggregate Supply and Demand.

- A. *Long Run Aggregate Supply***
 - 1. The classical model
 - a) Labor supply
 - b) Labor demand
 - c) Production function
 - 2. Determinants of potential GDP and LAS
- B. *Short run aggregate supply***
 - 1. Sticky wages
 - 2. As price level rises, movement along LAS causes
 - a) Real wages to fall
 - b) Employment to rise
 - c) Real GDP to rise
 - 3. Shifts in SAS
- C. *Aggregate demand***
 - 1. $C + I + G + (X-M)$
 - 2. Why AD drops when price level rises
 - a) Wealth effect
 - b) Intertemporal substitution effect
 - c) International Substitution effect

3. Factors causing changes in AD
- D. *How economy returns to long run equilibrium*
 1. Starting from $GDP > \text{potential GDP}$ (inflationary gap)
 2. Starting from $GDP < \text{potential GDP}$ (recessionary gap)
- E. *Macro schools of thought*
 1. Classical
 2. Keynesian
 3. Monetarist

IX. Ch. 13: Inflation, Unemployment and Business cycles.

- A. *Demand pull vs. cost-push inflation.*
- B. *Phillips Curve*
 1. Short run
 2. Long run
 3. Importance of inflation expectations.
 4. Link from AD/AS model to Phillips curve.
- C. *Business cycle theories.*
 1. Demand side theories
 2. Real business cycle theories
 - a) Productivity shocks cause business cycle.
 - b) Effect of productivity shock
 - (1) *real wages, employment*
 - (2) *interest rates, investment.*

X. Ch. 14: Fiscal Policy.

A. *Federal budget process*

B. *Recent budget issues*

1. Economic stimulus act
2. Major sources of tax revenue
3. Major spending categories
4. Relationship between deficit and debt

C. *Supply side economics*

1. Effect of taxes
 - a) Labor market
 - b) Long run aggregate supply
2. Distribution of the tax burden and trends.
3. The Laffer Curve.
 - a) Tax rates and tax revenue
 - b) Effect of tax rates on tax avoidance.
4. Effect of taxes
 - a) Investment and saving
 - b) Crowding out
 - c) Ricardo-Barro effects on crowding out

D. *Fiscal policy*

1. Discretionary
2. Automatic stabilizers.
3. Limitations of fiscal policy

E. *The budget and the business cycle*

1. Actual budget
2. Cyclical budget
3. Structural Budget
4. The effect of business cycle on the budget.

XI. Ch.15: Monetary policy.

A. Monetary policy objectives.

B. *Equation of exchange*

C. *Taylor's rule*

D. *The link between the FFR and other interest rates*

1. Short term rates
2. Long term rates

E. *The effect of monetary policy on the economy.*

1. Effect on consumption and investment
2. Effect on net exports through effect on exchange rate.

F. *The current financial crisis.*

- 1. Links to housing market and subprime loans.**
- 2. Fed and Treasury response to crisis.**