Macro-Economic s Test #3 Review:

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| --- | --- |
| 1. Formula to calculate **GDP**
 | GDP = C + I + G + Nx |
| 1. 4 sectors of an economy

a)Household Sectorb) Business Sector c) Government Sectord) Foreign Sector | Expenditures of the four sectorsConsumption 🡺 expenditure of HouseholdsInvestment 🡺 expenditure of BusinessesGovernment purchases🡺 expenditure of Government Net Export 🡺 expenditure of Foreign people (Exports-Imports) |
| 1. Disposal Income (DI) is
 | Take home incomeFormula = Personal Income - Taxes |
| 1. Disposal Income can be disposed in two ways
 | Consumption (C) = DI - SSaving (S) = DI - C |
| 1. How does the US economy spend?
 | Depends on: Marginal Propensity to Consume (MPC) Marginal Propensity to Save (MPS)* MPC + MPS = 1

EX: MPC = .60 then MPS = .40 |
| 1. Regular or Expenditure Multiplier of an economy
 |  EX:   Present multiplier 1/1-.60=1/.40=2.5 b/c President Obama injected $787 billion in the economy for economic stimulus plan.  |
| 1. John Maynard Keynes adopted demand side policy, so most of the goods and services produced in an economy are purchased by:
 | “You and me- consumers”, we purchase 68% goods and services that produced in the economy (which is more than 2/3), Businesses expenditure(16%) and government expenditure (18%) Net exports -2% |
| 1. When marginal propensity to consume decreases

When marginal propensity to consume increases | The spending multiplier decreases The spending multiplier increases |
| 1. Economy has 2 sides:
 | * **Aggregate Demand**
* Goods and services produced in an economy are purchased by 4 sectors
* { AD= C + I + G + Nx 🡺Open economy ( Foreign Trade)
* Downward sloping
* Price Level and Real GDP have Inverse or Negative relationship
* **Aggregate Supply**
* Goods and services produced by all firms in an economy
* Upward sloping
* Price Level and Real GDP has positive relationship
* Price Level Increases =Quantity supplied increases
 |
| 1. 3 reasons why the AD curve slopes downward
 | 1. **Wealth Effect or Real Balance Effect**

*Price Level↑🡺 Purchasing Power of Money↓ 🡺 Consumer purchasing power ↓ People buy less goods and services🡺AD↓**Price Level↓🡺 Purchasing Power of Money↑ 🡺 Consumer purchasing power ↑ People buy more goods and services🡺AD↑*1. **Interest Rate Effect**
2. **Net Export Effect or Foreign Trade Effect**
 |
| 1. Aggregate Demand shifts:
 | AD upward shift is increaseAD backward shift is decrease***AD↑= C ↑+ I ↑+ G ↑+ (X – M)↑******AD↓= C ↓+ I↓ + G ↓+ (X – M)↓*** |
| 1. Aggregate Quantity Demanded
 |  Depends on general price level ( Inversely related) |
| 1. Aggregate Supply
 | * **Short-Run**
* **Long-Run**

Fully ProductiveFull Employment level of outputVertical slopeMaximum Capacity of Land, Labor, Capital, and EntrepreneurshipNatural Rate of Output |
| 1. Classical Economics
 | JB Says said “Supply Creates its own Demand” |
| 1. Keynesian Economics
 | Keynes said “Demand Creates its own Supply” |
| 1. Stabilizing Policies were Keynes’ idea:
 | * **Monetary Policy**

*Controlling Money Supply* in an economyFederal Reserve System-Central Bank of US* **Fiscal Policy**

*Controlling Real GDP*President and Congress *2 Tools:* 1. ***Government Expenditures***
2. ***Taxes***

*To Achieve Certain Macro Economic Goals like increase in Real GDP decrease unemployment and decrease inflation rate* |
| 1. Federal Reserve System-Fed
 | **Board of Governors*** 7 members
* Appointed by President with Senate’s approval
* Serve for 14 years
* Present Chairman of Board of Governors is **Ben Bernanke**
* Past Chairman of Board of Governors was **Allen Greenspan**
 |
| 1. Expansionary Fiscal Policy
 | *Government Expenditure ↑ 🡺Taxes ↓🡺Disposal Income↑**Stimulate the economy with Tax cut 🡺More Money 🡺More Spending 🡺 Employment↑*Used during Recessionary Gap (Underproduction)  |
| 1. Contractionary Fiscal Policy
 | *Government Expenditure ↓🡺 Taxes↑🡺Disposal Income↓🡺Less Money🡺Less Spending 🡺Employment ↓*Used during Inflationary Gap (Overproduction)  |
| 1. Automatic Fiscal Policy
 | No Congress ApprovalPresent – 75% |
| 1. Discretionary Fiscal Policy
 | Needs Congress ApprovalPresent – 25% |
| 1. Appropriate Fiscal Policy for Recessionary Gap

Appropriate Fiscal Policy for Inflationary Gap  | Expansionary Fiscal Policy  Contraction Fiscal policy |
| 1. 3 Functions of Money
 | Medium ExchangeStore of ValueUnit of Account |
| 1. Paper Money using in the US is called
 | Federal Reverse Notes –largest component of M1 money |
| 1. Liquidity of Money
 | How quick (The ease of convert an asset into spendable money ) |
| 1. 3 Types of Money
 | **M1 Money:**Highly Liquid*Ex: Traveler’s Checks, Checking Account, Currency & Coins, Money Orders***M2 Money:**Slightly Less Liquid*Ex: Saving Account, Mutual Fund, Timely Deposit < $100,000***M3 Money:**Slightly Liquid*Ex: Timely Deposit > $100,000* |
| 1. Opportunity Cost of Holding Money
 | **Related Inversely with Interest Rate**Ex: Interest ↑🡺People hold less money🡺Deposit More into Banks Interest ↓🡺People hold more money🡺Deposit Less into Banks |
| 1. Money Market
 | The demand for money and the supply of money determine the interest rate (or level of the interest rate) in the economy |
| 1. How many Commercial Banks are there?
 |  Around 7500 |
| 1. How many Federal Reserve Banks are there?
 | 12 Branches |
| 1. Federal Reserve System is
 | The central bank of the USControls the money supply in the economy(Conducts monetary policy)Lender of the last resortPrints currencyActs as bankers' bankActs as Government's bank |
| 1. 1st Bankers
 | Goldsmiths |
| 1. Are credit Cards Money?
 | No, just helping the exchange transaction between sellers and buyers |
| 1. What is US banking system at present?
 | Fractional Reserve System🡺 Only a fractional of money is required to operate the bank. |
| 1. How much is the reserve requirement ratio for US Commercial banks?
 | 10% |
| 1. What is a closed economy?
 | Economy without foreign trade [GDP= C + I + G] |
| 1. US Treasury is the only source of money in the economy
 | False |
| 1. At highest interest rate, demand for money increases
 | False |
| 1. Loans made to the customer are liability in the balance sheet
 | False |
| 1. If the reserve requirement ratio is 10%, what is the money multiplier?
 | 10 times |
| 1. Tight Monetary Policy
 | Tools to decrease Money Supply in the economyOpen Market SaleIncrease in reserve requirement ratio( r.r.r)Increase in Discount Rate |
| 1. Loose Monetary Policy
 |  Tools to increase Money Supply in the economyOpen Market PurchasesDecrease in reserve requirement ratio( r.r.r)Decrease in Discount Rate |
| 1. Adam Smith Policy
 | Laissez Faire PolicyStable economyNon Government intervention in Economic matters |
| 1. John Maynard Keynes
 | Instable economyGovernment intervention is needed in the economic matters |
| 1. Most Open Market Operations conducted by
 | NYSE |
| 1. If the Government increases Government Expenditure or decrease taxes to fix the economy is called
 | Expansionary Fiscal Policy |
| 1. If the Government decreases government expenditure and increases Taxes to fix the economy is called
 | Contractionary Fiscal policy |
| 1. Central bank of US is called
 | The Federal Reserve System (Fed) |
| 1. The main function of Fed
 | Conducting Monetary Policy = Controlling the Money Supply |
| 1. Who create money in the economy?
 | Commercial Banks  |
| 1. Current US MPC
 | 60% |
| 1. Current US MPS
 | 40% |
| 1. Current Multiplier
 | 2.5 |
| 1. Checkable Deposits, M1 Money are called as
 | Demand Deposits |