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 Sector  b) Business Sector  c) Government Sector  d) Foreign Sector | Expenditures of the four sectors  Consumption 🡺 expenditure of Households  Investment 🡺 expenditure of Businesses  Government purchases🡺 expenditure of Government  Net Export 🡺 expenditure of Foreign people (Exports-Imports) |
| 1. Disposal Income (DI) is | Take home income  Formula = Personal Income - Taxes |
| 1. Disposal Income can be disposed in two ways | Consumption (C) = DI - S  Saving (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 increase  AD 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 Productive  Full Employment level of output  Vertical slope  Maximum Capacity of Land, Labor, Capital, and Entrepreneurship  Natural 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 economy  Federal 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 Approval  Present – 75% |
| 1. Discretionary Fiscal Policy | Needs Congress Approval  Present – 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 Exchange  Store of Value  Unit 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 US  Controls the money supply in the economy(Conducts monetary policy)  Lender of the last resort  Prints currency  Acts as bankers' bank  Acts 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 economy  Open Market Sale  Increase in reserve requirement ratio( r.r.r)  Increase in Discount Rate |
| 1. Loose Monetary Policy | Tools to increase Money Supply in the economy  Open Market Purchases  Decrease in reserve requirement ratio( r.r.r)  Decrease in Discount Rate |
| 1. Adam Smith Policy | Laissez Faire Policy  Stable economy  Non Government intervention in Economic matters |
| 1. John Maynard Keynes | Instable economy  Government 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 |