

Midterm 2: Key Concepts and Definitions

- The difference between the quantity demanded/supplied and demand/supply
- What causes shifts in curves and what causes movements along a curve
- The difference between short-run and long-run time spans
- Potential GDP and why it could increase/decrease
- What causes shifts in *LAS*, *SAS*, *AD*, *APE* curves, and the sequence of these shifts depending on a particular situation
- What shifts in the long-run vs. what shift in the short-run
- Intertemporal substitution effect
- Short-run and long-run macro equilibriums
- What represents economic growth and inflation in the AS-AD model
- Aggregate planned expenditure and its components
- Disposable income and the identities related to it
- Consumption function and characteristics/meanings of its slope and intercept
- Consumption vs. saving
- Induced vs. autonomous consumption
- Induced vs. autonomous expenditure
- The slope in consumption function vs. the slope in the *APE* function
- Actual vs. planned expenditure
- Equilibrium expenditure
- Keynesian cross
- **Expenditure multiplier and its derivation**
- The magnitude of the multiplier in the shortest run, short-run, and long-run
- Relation of AE model to AS-AD model and the ability to represent it graphically:
 - sequence of events if the aggregate planned expenditure changes first
 - sequence of events if the price level changes first
- Why is the concept of multiplier important?
- Business cycle and its components (peak, trough, etc.)
- Why should we care about the business cycle?
- Economic growth vs. business cycle
- The business cycle in the AS-AD framework
- Inflation cycles and their relation to the business cycle
- Demand-pull inflation: definition, examples (hypothetical and historical), and its graphical representation
- Cost-push inflation: definition, examples (hypothetical and historical), and its graphical representation
- Stagflation and its causes
- Rational expectation
- Relation of the rational expectation about inflation to the types of inflation
- Definition, functions, and measures (with their components) of money in the U.S.
- Currency
- Deposit
- Liquidity
- Depository institutions: definition, types, and economic benefits
- How do depository institutions make profit

Formulas

Accounting identity: $GDP = C + I + G + NX$

Aggregate income: $Y = GDP$

Aggregate expenditure: $AE = GDP = Y$

Aggregate planned expenditure: $APE = C^P + I^P + G^P + MX^P$

Disposable income: $YD = Y - T$

Saving: $S = YD - C$

Consumption function: $C = a + b \cdot YD$

Expenditure multiplier: $M = \frac{1}{1 - \text{slope of } APE \text{ curve}}$

How to study for the test

1. Make sure you understand all the concepts on page 1.
NOTE THAT THE MATERIAL ON THE TEST WILL NOT BE LIMITED TO THE CONCEPTS AND DEFINITIONS LISTED ON PAGE 1. HOWEVER, IF YOU KNOW THESE, YOU WILL BE ABLE TO ANSWER THE MAJORITY OF QUESTIONS CORRECTLY.
2. Know formulas on page 2
3. Redo the homework – I compiled all the homeworks into one file which you can find on my website. I recommend printing it out and trying to work on it as you would on the test
4. Redo the quizzes
5. Do the practice tests
6. Try to come up with your own examples – this is a very good way to find out whether you truly understand a concept or not
7. Practice graphs a lot

The class slides cover all the concepts you should know for the test. The textbook is there for you to get a better understanding of what is in the slides. If we didn't cover in class something that is in a textbook chapter, you are not responsible for it.

Readings:

CH10: 242-255

CH11: 266-267 until the “Saving Function”; 270-283; 286-287

CH12: 296; 301-307 until the “The Quantity Theory and Deflation”

CH08: 182-184; 185: stop reading after the 5th paragraph in the second column that starts with “A commercial bank puts the funds...”; 186: only “Economic Benefits Provided by Depository Institutions”