Concepts for final exam review

1. Macroeconomic accounting identity: Y = C + I + G + (X - M)Factors affecting changes in GDP; link between trade sector and GDP trade sector and GDPExternal sector affects domestic economy and vice versa2. Balance of trade (BOT): BOT = (X - M) = (S ^P - I _D) - (G - T)Domestic macroeconomic imbalances linked to BOT imbalances linked to BOT imbalances in the official reserve position (R)BOT related to the K-acct (private outflows/ inflows) and changes in the official reserve position (R)BOT imbalance must be offset by K flows; under fixed E regime AR matters too4. Exchange rate (E):E, P relationship; $\Delta E = \Delta P$; $1 (1) E \rightarrow \downarrow (\uparrow)$ lo valueE is the mechanism to ensure LOOP and TOT hold for goods/services. E is the mechanism to ensure LOOP for assets. ensures that i _H , [iF] ^e give same return on lc, fc assets i _H > [iF] ^e + [(E ^e - E ₀)/E ₀] + risk premiumE is the mechanism to ensure fully implementation (1) E $\rightarrow \uparrow$ e ^e E is the mechanism to ensure LOOP for assets. ensures that i _H , [iF] ^e give same return on lc, fc assets i _H > [iF] ^e + [(E ^e - E ₀)/E ₀] + risk premiumFirsk inplies ΔE^e , ΔP^e , [iF] ^e If risk is not the same, investors will requie a premium to hold risky asset; Δ Expectations can affect real economy5. Modeling exchange rates and changes in temperating of e(D _{fe} , S _{fe}) and E ΔD_{fc} and $S_{fc} \rightarrow \Delta E$ Market for fc can behave like any other marketIntervention in currency markets is similar to the effects on trade depend on elasticities; Depreciating/devaluing and consumming, and production and consumming, and production parments, and production parments, and production parments, and production parec
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5. Modeling exchange rates and changes in equilibrium: ΔD_{fc} and $S_{fc} \rightarrow \Delta E$ Intervention in currency5.1 Determination of exchange rate ΔD_{fc} and $S_{fc} \rightarrow \Delta E$ Intervention in currencyDemand, supply of fc (D_{fc} , S_{fc}) and EMarket for fc can behavemarkets is similar to theDemand, supply of fc (D_{fc} , S_{fc}) and E $\Delta E \rightarrow \Delta trade (X, M)$ and ΔE effects on trade5.2 Modeling trade flows from ΔE $\Delta E \rightarrow \Delta trade (X, M)$ and ΔE effects on tradeHouck 3-country model: ES, ED in lc, fcpayments, and productionDepreciating/devaluing
5.1 Determination of exchange rate ΔD_{fc} and $S_{fc} \rightarrow \Delta E$ Intervention in currency markets is similar to the effects of trade policy (tax on X, M; subsidy on X, M or quotas) 5.2 Modeling trade flows from ΔE $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import payments, and production and consumption $\Delta E = ffects on tradedepend on elasticities;Depreciating/devaluinglc can improve BOT$
5.1 Determination of exchange rateMarket for fc can behave like any other marketmarkets is similar to the effects of trade policy (tax on X, M; subsidy on X, M or quotas)Demand, supply of fc (D_{fc} , S_{fc}) and E $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import ΔE effects on trade depend on elasticities;5.2 Modeling trade flows from ΔE $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import ΔE effects on trade depend on elasticities;Houck 3-country model: ES, ED in lc, fcpayments, and production and consumptionDepreciating/devaluing lc can improve BOT
Demand, supply of fc (Dfc, Sfc) and Elike any other marketeffects of trade policy (tax on X, M; subsidy on X, M or quotas)5.2 Modeling trade flows from Δ E $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import ΔE effects on trade depend on elasticities;Houck 3-country model: ES, ED in lc, fcpayments, and production and consumptionDepreciating/devaluing lc can improve BOT
Demand, supply of fc (D_{fc} , S_{fc}) and E(tax on X, M; subsidy on X, M or quotas)5.2 Modeling trade flows from Δ E $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import ΔE effects on trade depend on elasticities;Houck 3-country model: ES, ED in lc, fcpayments, and production and consumptionDepreciating/devaluing lc can improve BOT
5.2 Modeling trade flows from Δ E $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import ΔE effects on trade depend on elasticities;Houck 3-country model: ES, ED in lc, fcpayments, and production and consumptionDepreciating/devaluing lc can improve BOT
5.2 Modeling trade flows from ΔE Houck 3-country model: ES, ED in lc, fc $\Delta E \rightarrow \Delta trade (X, M)$ and export earnings, import payments, and production and consumption ΔE effects on trade depend on elasticities; Depreciating/devaluing lc can improve BOT
Houck 3-country model: ES, ED in lc, fc Houck 3-country model: ES, ED in lc, fc
Houck 3-country model: ES, ED in lc, fc and consumption Depreciating/devaluing
$\uparrow E \rightarrow \uparrow BOT \rightarrow \uparrow V \text{ under} AE \rightarrow \text{slow } AP = \alpha$
5.3 I-curve effect the right conditions: or just long-term contract
to improve BOT and BOP buyer-seller relations).
situation. so P in lc terms can
Implication of decreasing currency value change faster than in fc
(competitive depreciation) BOT can worsen in short terms, and trade
run with $\uparrow E (\downarrow lc value)$ quantities are inelastic
5.4 Marshall-Lerner condition: $\xi^{ES}_{E} + \xi^{ED}_{E} \ge 1$ to improve Degree to which ES and
BOT; if < 1 then $\uparrow E$ ED are affected by ΔE
ES, ED elasticities with respect to ΔE worsens BOT. are an empirical matter.
6. General equilibrium:
6.1 Goods market equilibrium:
interest: 1, Y and E, Y. 1, Y in which goods mkt
$Y = C(Y) + I(i) + G + BOT(E \cdot P_F/P_H; Y)$ $AIS: anything causing TY$ $IS in equiv.$ $DD arrow all combined$
(notating $1 - 10$) DD curve: all combos ADD: anything causing tV of E. V in which goods
$AD = C(Y) + I(i) + G + E \cdot P_F/P_H = AS$ (holding $E = E_0$)

4.1 Interest rate parity, asset market eqlbm



5.1 Foreign exchange market



5.2 Modeling exchange rate changes on trade

Good priced in lead (international reserve) currency terms, P_w



Concept	Cause-effect relationship	Issue(s)
6. General equilibrium:		
6.1 Goods market equilibrium:	Two relationships of interest: i, Y and E, Y.	IS curve: all combos of i, Y in which goods mkt is in
$Y = C(Y) + I(i) + G + BOT(E \cdot P_F / P_H; Y)$	Δ IS: anything causing \uparrow Y (holding i = i ₀)	eqlbm. DD curve: all combos of E,
$AD = C(Y) + I(i) + G + E \cdot P_F / P_H = AS$	Δ DD: anything causing \uparrow Y (holding E = E ₀)	Y in which goods mkt is in eqlbm.
	Interest in the i, Y	BP curve: all combos of i,
6.2 BOP equilibrium:	relationship. ∆BP: anything causing ↑Y	Y in which BOP is in eqlbm.
$BOP = BOT(E \cdot P_F/P_H; Y) = K-in(i)$	(holding $i = i_0$) The flatter is BP curve the	Slope of BP curve relates to the degree of K
	more mobile is capital.	mobility.
6.3 Money – asset market equilibrium:	Two relationsships of interest: i, Y and E, Y. ALM: anything causing	LM curve: all combos of 1, Y in which money mkt is in calbm
$[MS/P] = [MD/P] = L_{i,Y}$	\uparrow Y (holding i = i ₀) ΔAA: anything causing	AA curve: all combos of E, Y in which money mkt is
	$\uparrow Y$ (holding $E = E_0$)	in eqlbm.
6.3.1 Money – asset market confirms covered interest parity	$\Delta MS/P: \uparrow MS/P \rightarrow \downarrow 1, \uparrow E$ $\Delta MD/P: \uparrow MD/P \rightarrow \uparrow E, \downarrow i$	changes in MS or MD affect real economy only if P are slow to change
E*, i ₀ in both asset market and money market		Dynamic effect when P start to change.
6.3.2 Fisher effect: effect of ΔP	P, i-rate relationship; Δ in	Investors are interested in
$i_{Real} = i_{Nominal} - P_{H}$	i-rate follow Δ P to keep real rates same: $\uparrow P_H \rightarrow \uparrow i_H$	real interest rates
	$\uparrow P - if it affects$	KOM text: effect of
6.3.3 Overshooting hypothesis:	expectations – can result in the following causal	overshooting can move E away from PPP.
ΔP and $\Delta expectations$ on E^e , P^e and $[i_F]^e$	effect $\rightarrow \uparrow P^e \rightarrow \uparrow E^e \rightarrow \uparrow$ [i_F] ^e (shift up in [i_F] ^e curve)	
6.4 Changes in general equilbrium	Allow some variable to	Understand the changes as
	change and their effect	they relate to the type of
IS-LM-BP curves	through system	exchange rate regime and
AA-DD curves	$\Delta i, Y \text{ and } \Delta E, Y$	the degree of capital
$MS/P = L_{i,Y}$ and $I_{H}-[I_{F}]^{\circ}$ equipm		mobility.
7.1 Fiscal and monetary policy		The degree to which V
7.1 Fiscal policy (FP)	$\Delta G \rightarrow \Delta IS \rightarrow \Delta I, I$	changes depends on how
G, T, (G-T) and debt		much i, E change.
	ΔG , ΔY relationship	Depends on exchange
7.1.1 Effectiveness of FP	depends on how i, E are	regime and degree of
	affected; how BP curve is	capital mobility. It also
Use of the IS-LM-BP framework, AA- DD, and MS/P = $L_{i,Y}$ and i_{H} -[i_{F}] ^e eqlbm	bank might do (AA, LM	change.
	$\uparrow G \rightarrow \uparrow i \rightarrow \bot I$	If K-inflows are limited
7.1.2 Crowding out effect	The $\uparrow G \rightarrow \uparrow Y$ is offset	and domestic savings are
Governments compete for loanable funds	$by \downarrow I \to \downarrow Y$	low, then loanable funds
with private sector		for the private sector
		become scarcer.

7.2 Monetary policy (MP)	ΔMS , ΔY relationship	Depends on exchange
	depends on how i, E are	regime and degree of
MS, i-rate, bank reserves, central bank	affected; how BP, IS, and	capital mobility. It also
reserves (R), open market operations,	DD curves are affected.	depends on how fast prices
cost of borrowing		change.
	Fixed $E_{lc/fc}$ at E_0 implies	There are various types of
7.2.1 MP and fixed exchange rate regime	$\Delta E = 0$, then $\Delta P_{\rm H} = \Delta P_{\rm F}$	fixed exchange regime.
	and $i_{\rm H} = [i_{\rm F}]^{\rm e} + \Delta E = 0;$	The stricter is the fix, the
Advantages and disadvantages of a fix	central bank must use MP	more these conditions must
	to keep E at E_0	hold.
	Central bank targets either	When E is flexible MP is
7.2.2 MP and flexible exchange regimes	MS growth or inflation;	more effective and central
	inflation targeting came	banks have more
Central bank independence	about from central bank's	independence.
	ability to control inflation	
	A country cannot have a	A choice of two is possible
7.2.2 Trilommo or impossible trinity	fixed E, free movement of	or some trade-off of the
7.2.5 Themina of impossible unity	K and independent central	three.
	bank all at the same time.	
7.2.4 Inflation and unemployment	Phillips curve relationship	Low unemployment and
	of low inflation, high	low or deflation (high rates
Inflation targeting as a means to keep Y	unemployment has broken	of employment without
at Y_n and u at u_n at low, stable inflation	down	upward wage pressure)
7.2.5. Un out had an un an atoms malian	Low inflation, deflation	Traditional MP unable to
7.2.5 Unorthodox monetary policy	$\rightarrow \downarrow$ domestic demand \rightarrow	work to \uparrow AD; QE and
Quantitative agains and as active i notes	\downarrow Y	negative i-rates serve to
Quantitative easing and negative 1-rates		add liquidity and spending
8 Aggragate demand and supply		
8. Aggregate demand and suppry.		
8. Aggregate demand and suppry.	P, Y relationship:	AD here includes the effect
8.1 AD AS and relationship with price	P, Y relationship:	AD here includes the effect of the money market on
8.1 AD, AS and relationship with price	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$,	AD here includes the effect of the money market on goods to ensure money
8.1 AD, AS and relationship with price	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$	AD here includes the effect of the money market on goods to ensure money market changes effect on
8.1 AD, AS and relationship with price	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS:	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into
8.1 AD, AS and relationship with price	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account.
8.1 AD, AS and relationship with price	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship)	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account.
 Aggregate demand and suppry. 8.1 AD, AS and relationship with price AD: downward sloping in P 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship)	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor
AD: downward sloping in P + - + + + + + V(M/P: C(Y) I(i Y) G BOT(F:Pr/Pr:Y)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y _n is the natural
AD: downward sloping in P + - + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y _n is the natural rate of output and N* is the
AD: downward sloping in P + - + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level,
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P $AS = g(P, P^e)$	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at
AD: downward sloping in P + - + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y _n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u _n . At Y _n ,
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e)	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS
 Aggregate demand and suppry. 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P \text{ and } \uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation.
 Aggregate demand and suppry. 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) Changes in AD 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation.
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e) 8.2 Determination of P (inflation, π) Changes in AD	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e) 8.2 Determination of P (inflation, π) Changes in AD	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in
 Aggregate demand and suppry. 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) Changes in AD 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes
8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e) 8.2 Determination of P (inflation, π) Changes in AD Changes in AS	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity and ΔP^e ; ΔP is movement	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment level, when unemployment is at its natural rate, u _n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes in expectations can result
 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) Changes in AD Changes in AS 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity and ΔP^e ; ΔP is movement along AS curve	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes in expectations can result in changes in prices.
 Aggregate demand and suppry. 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) Changes in AD Changes in AS 	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity and ΔP^e ; ΔP is movement along AS curve $\uparrow P^e \rightarrow \uparrow W$; $\uparrow W \rightarrow \uparrow costs$	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes in expectations can result in changes in prices.
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8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P _F /P _H ;Y) AS: upward sloping in P AS = g(P, P ^e) 8.2 Determination of P (inflation, π) Changes in AD Changes in AS	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity and ΔP^e ; ΔP is movement along AS curve $\uparrow P^e \rightarrow \uparrow W$; $\uparrow W \rightarrow \uparrow costs$ $\rightarrow \uparrow P$ by firm and general prices, (inflation, π)	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment level, when unemployment is at its natural rate, u_n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes in expectations can result in changes in prices.
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 8.1 AD, AS and relationship with price AD: downward sloping in P + - + + + + + + + + + + + Y(M/P; C(Y), I(i,Y), G, BOT(E·P_F/P_H;Y) AS: upward sloping in P AS = g(P, P^e) 8.2 Determination of P (inflation, π) Changes in AD Changes in AS 8.3 Use of AD-AS to show ΔP in general equilibrium	P, Y relationship: AD: $\uparrow P_H \rightarrow \downarrow M/P$, $\downarrow BOT \rightarrow \downarrow Y$ AS: $\uparrow Y \rightarrow \uparrow P$ and $\uparrow P^e \rightarrow \uparrow P$ (one for one relationship) Process: $\uparrow Y \rightarrow \uparrow N$ (employment); $\uparrow N \rightarrow \downarrow u$ (unemployment); $\downarrow u \rightarrow \uparrow$ W (wage); $\uparrow W \rightarrow \uparrow P$ AD = AS = P* = P ^e A Δ factor affecting AD \rightarrow shift in AD; ΔP is movement along AD curve AS shifts: Δ productivity and ΔP^e ; ΔP is movement along AS curve $\uparrow P^e \rightarrow \uparrow W$; $\uparrow W \rightarrow \uparrow costs$ $\rightarrow \uparrow P$ by firm and general prices, (inflation, π) Link between ΔP and IS- LM-BP; AA-DD; and	AD here includes the effect of the money market on goods to ensure money market changes effect on goods mkt is taken into account. AS is linked to the labor market; Y_n is the natural rate of output and N* is the optimal employment level, when unemployment is at its natural rate, u _n . At Y_n , $P = P^* = P^e$ Changes in AD and AS affect rate of inflation. Changes in prices can result in changes in expectations and changes in expectations can result in changes in prices.

6.0 – 8.3 General equilibrium: AA-DD, IS-LM-BP and asset mkt-money market



Concept	Cause-effect relationship	Issue(s)	
9. Alternative exchange regimes: optimal currency area and monetary union			
9.1 Range of fix/flexible regimes	Recall the implications of a fix	/flexible and the	
	advantages and disadvantages	1	
9.2 Optimal currency area	• Free trade in goods and	The theory is not precise	
	services	on the goodness of any	
Economic criteria for an optimal	• Capital/labor markets are	type of exchange regime.	
currency area	integrated, flexible and		
	mobile		
	• No asymmetric shocks		
	• Fiscal stabilization		
9.3 Monetary union	The application of the	The euro area is an	
	optimal currency criteria to	example of proceeding	
	real-world situations is not	with economic	
	straightforward. Among	integration before	
	nation states there is much	completing the political	
	political integration that is	integration.	
	necessary: a supranational		
	central bank, constraints over		
	FP, mutualization of debt.		