**ECO 304L Exam 1 Study Guide (11am)**

**You will find questions on the exam relating to the media shown in class and used for Kahoots!**

**Exam:** Tuesday February 13th, 11am-12:15pm in-class (JES A121A)

**Please bring a pencil, an eraser and your ID card and arrive by 10:40am.**

**FAQs**

**What is the exam worth?** 240 points (24%).

**What is the exam format?** 32 multiple choice and 8 short answer questions each worth 1 point. You will get a score /40, scaled to a score /240 when grades are uploaded to Canvas.

Partial credit is available for short answer questions if your answer is wrong but you explain your reasoning/working.

**What chapters are covered?** Chapters 6-9.

**What materials are authorised?** This is a closed book, closed notes exam. You may use a physical calculator but may not use a cell phone or any other electronic device during the exam.

**Is there a sample exam?** You will find sample exam files for chapters 6-9 on Canvas, each with approximately 50 questions.

**If you miss exam 1, the final (cumulative) exam becomes mandatory.**

**How does the 3 skips rule work?** Skip any 3 questions – short answer or multiple choice. These are counted as correct. If you don’t skip 3 questions, i.e. choose to answer all 40 questions, they are graded as per normal.

**Should I read the syllabus?** Yes. One question from the exam will come directly from the syllabus 😊

**What happens if I miss the exam?** The final exam becomes mandatory.

**What’s the best way to prepare for the exam?**

1. Watch the lecture recording for each chapter. Go to Canvas, scroll down to Lectures Online (near the bottom).

2. Take the IQ quizzes in review mode.

3. Attempt the end-of-chapter questions.

4. Attempt the sample exam questions.

5. Attend the Supplementary Instruction sessions

6. Attend office hours if you need help. You can find the days/times for each TA on Canvas (click Modules, click office hours at the top). My availability is **Tuesday/Thursday, 1pm-4pm (BRB 2.102)**

7. I will give an exam review Kahoot in-class on Thursday February 8th.

**Chapter 6: GDP**

**Define GDP**: market value, final goods & services, produced within a specific period of time.

**Circular flow diagram**: link between income & expenditure.

**Included**: only final goods, & services current production.

**Excluded**: intermediate goods & transfer payments.

**Calculating GDP**: we can get an accurate measurement of GDP by taking the sale price of the final good or by taking the value added at each step along the way, but not both. That’s double counting.

**Components**: C + I + G + NX. Be able to give an example of all components. Know that consumption is the largest component in the American economy.

**Nominal v Real GDP:** nominal uses market prices; real GDP is adjusted for inflation (uses constant prices from a base year). **You should know how to calculate both.**

Know how to calculate economic growth & the GDP deflator.

Real GDP = Nominal GDP – Inflation.

**GDP per capita**: used to measure standard of living.

Understand trends over time: America has grown by c. 2% per year over the last 50 years, economic growth differs across nations.

**Business cycle**: short-run path looks like a snake; long-run trend of GDP is upwards.

**Problems with GDP:** does not account for non-market goods, underground economy, environmental damage, leisure time or the distribution of income.

Alternative measurements of welfare, happiness & standard of living, e.g. world happiness index

**Chapter 7: Unemployment**

Unemployment is never zero.

**3 types of unemployment**: structural, frictional & cyclical

**Structural**: caused by changes in the industrial make-up of the economy; linked with technology. Think of video rental stores v Netflix.

How has the American workforce changed over time? Think about the share of workers in agriculture, industry, and services.

**Frictional**: caused by the delay in matching available jobs & workers.

**Cyclical**: caused by an economic downturn; no jobs available ☹

**Natural Rate of Unemployment versus Full Employment**

**NRU:** associated with an economy growing normally.

**Full Employment**: no cyclical unemployment (still some structural & frictional).

**In a recession**: cyclical unemployment is > 0

**In a boom**: actual unemployment rate is less than the natural rate. This happens temporarily when the economy is expanding beyond its long-run capabilities.

**Measuring Unemployment**

**Labor force** = employed + unemployed

**Working-age population:** civilian, non-institutionalized, aged 16+

**Unemployment rate**: (unemployed/labor force) x 100

**Labor force participation rate**: (labor force/working age population) x 100

**You should know how to calculate all four.**

**Swimming Pool demonstration**: what happens to the unemployment rate when people find a job or stop looking for a job?

Is the current American unemployment rate actually 3.5% (December 2022)? There are different measurements of unemployment: narrow (U-3) – favored by the BLS.

U6: U3 + marginally attached + under-employed. Unemployment rate in this case is higher.

**Know how to classify workers**: employed, unemployed, not in the labor force.

Labor market data: differences in LFPR & unemployment rates.

Know the geography of unemployment in America over the last 20 years.

**Chapter 8: Inflation**

**Define inflation**: general rise in the average price level.

**Consumer Price Index (CPI)**: measurement of the price level based on the consumption patterns of a typical consumer.

**Compute a price index**: first, calculate the basket price. You will need to calculate the CPI across 2 years (possibly 3 years, if there is an earlier base year).

Year 1 (base year). CPI = 100. **(CPI1)**

Year 2: (basket price/basket price in base year) x 100 **(CPI2)**

Inflation: **(CPI2 – CPI1)/ CPI1 x 100**

Why don’t all prices move together? CPI tends to overstate inflation.

1. Substitution
2. Quality changes
3. New goods & services.

What are some alternative measures of inflation? Chained CPI, Billion Prices Project.

What are the costs of inflation?

1. Shoe-leather costs
2. Money illusion: confusing nominal & real prices
3. Menu costs: costs of changing prices
4. Future price level uncertainty: borrow, build, hire now, sell & repay later
5. Wealth redistribution: creditors versus debtors
6. Price confusion: is an increase in price a result of an increase in demand or inflation?
7. Tax distortion: capital gains

Using the CPI to compare dollar values across time (think of the highest grossing films of all time)

How do we explain inflation?

Equation of exchange: MV = PY (too much money supply growth)

Other factors:

1. Cost push: supply side (linked to rising costs)
2. Demand pull: demand side (too much demand chasing limited supply)

**Chapter 9: Savings & Investment**

Loanable funds market brings together borrowers (demand) and savers (supply).

Demand: investors and governments.

Firms borrow to invest; governments borrow to fund deficits.

**Chain**: savings > borrowing > investment > GDP

Loanable Funds market: in equilibrium, S = I (no surplus or shortage of funds).

IR: reward for savers; price of borrowing.

Changes in IR affect viability of investment.

Fisher Effect: real IR (r) = nominal IR (i) – inflation rate (π).

IR corrected for inflation.

When inflation rises, nominal IR rises to preserve real IR.

**Supply Curve of Loanable Funds**

Movement along: change in IR

Shift caused by:

1. Changes in income & wealth: positive relationship
2. Changes in time preference: negative relationship (high preference, want now)
3. Consumption smoothing: early life (borrow); prime earning (save); retire (dissave)

Savings rate fell in the U.S. for 3 decades before COVID.

**Demand Curve for Loanable Funds**

Movement along: change in IR

Shift caused by:

1. Changes in productivity of capital
2. Changes in investor confidence
3. Government borrowing

**Equilibrium in Loanable Funds Market**

Every dollar borrowed requires a dollar saved.

Price that clears the market is the IR.

What happens when either or both curves shift?

Be able to identify the new equilibrium.

**Future of the Loanable Funds Market in the U.S.**

Baby boomers retiring & increase in time preferences (shift left) v increase in foreign savings (shift right).