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Basic Economic Concepts
Unit 1 ↓

- **Scarcity** is created by unlimited wants and limited resources
- Economics is the study of scarcity and **opportunity cost** - the price of the next best thing when **trade-offs** are made, **Economic systems** dictate how scarce resources are **allocated**
- We model opportunity cost on the **production possibilities curve (PPC)**
- **Straight** = const. OC, **bowed out** = increasing OC
- The law of **comparative advantage (CA)** tells us how countries can increase productivity by **specializing** and **trading**
- **CA:** output: OTHER value goes over; input: IT goes over
- **Absolute Advantage:** country that can produce more
- The country with the lower OC for a good, will specialize in it
- **Supply and Demand** describe how markets are a relationship of buyers and sellers (**surplus** = Qd < Qs, **shortage** = Qd > Qs)

Economic Indicators and the Business Cycle
Unit 2 ↓

- The **circular flow model** which shows that money in an economy flows in an endless circle (from firms, individuals, the gov, etc.)
- **Gross Domestic Product** (GDP) is the dollar value of all finished goods and services produced in a countries border in one year
- **Expenditure Approach**: GDP = C + I + G + (X - N)
- **Income Approach**: GDP = W + i + R + P
- **Value Added Approach**: GDP = VOGS – IC
- Limitations of GDP: Does not determine quality of life
- **GDP Per Capita** (GDP/Pop) can tell us about quality of life
- **Labor Force**: all people who are able and willing to work
- **Unemployment rate** = unemployed in LF/total LF * 100
- Types of Unemployment: **Cyclical, Frictional, Structural**
- **Natural Rate of Unemployment** = no cyclical unemployment
- **Inflation** (increase in PL, helps borrowers, hurts lenders) is measured using **CPI** and **GDP Deflator -** unemployment hurts some and benefits others
- Economic indicators are summarized in the **business cycle**

National Income and Price Determination
Unit 3 ↓

- **Aggregate Demand** is shifted by changes in C, I, G, Xn
- AD is downward sloping b/c of the **wealth** effect, **interest rate** effect, and **exchange rate** effect
- The multiplier effect explains how gov't spending can increase GDP more than the amount spent
- MPC = **ΔC/ΔI**, MPS = **ΔS/ΔI**, **MPC + MPS = 1**
- **Spending Mult** = 1/MPS, **Tax Mult** = MPC/MPS
- ΔGDP = **ΔS * Spending Mult** or ΔGDP = **-ΔT * Tax Mult**
- **Short Run Aggregate Supply (SRAS)** is shifted by changes in production costs
- Economic growth is shown by the **Long Run Aggregate Supply** (LRAS), which is vertical at the NRU
- When the economy is not at **long run equilibrium,** it is either in an **inflationary** or **recessionary** gap
- The market adjusts in the long run (SRAS shifts)
- **Fiscal Policy**: changing **spending/taxes** to shift AD

Financial Sector
Unit 4 ↓

- **Money** has three functions: medium of exchange, store of value, and unit of account
- **Liquidity** is how fast an asset can be turned into cash (most liquid is M1)
- **Interest** is the "price" of money, or the opportunity cost of holding money instead of investing
- **Real IR = Nom IR - Inflation Rate** (Fisher Equation)
- The **money supply** consists of M0, M1, and M2 money,
- M1 contains M0, and M2 contains M1 and M0
- **Bank Balance Sheets** contain assets and liabilities
- Banks have a **required reserve ratio** set by the Fed
- **Money Multiplier = 1/rr** can be used to calculate changes in the money supply
- The **Money Market** describes the **demand for money** based on the **nominal interest rate**
- The **money supply** is vertical because it is set by the Fed
- Tools of **Monetary Policy**: Buying/selling bonds (OMOs), **required reserve ratio**, the **discount rate**, and **fed funds rate**
- OMO's are more effective because of the money multiplier
- **Expansionary MP** → MS↑ → Nom IR↓ → I↑ → AD↑
- **Contractionary MP** → MS↓ → Nom IR↑ → I↓ → AD↓
- The **Loanable Funds Market** brings together lenders and borrowers based on **real interest rates**

Long-Run Consequences of Stabilization Policies
Unit 5 ↓

- Fiscal and monetary policies can be used in unison to **restore full employment**
- **Supply-side** economics (known as trickle-down-economics) is the concept of cutting business taxes to help the economy and
- The **short-run Phillips curve** displays a trade-off between inflation and unemployment
- The **long-run Phillips curve** is vertical at the natural rate of unemployment
- The **Phillips Curve** can display inflationary and recessionary gaps
- Shifts in AD move **along** the SRPC and shifts in SRAS **shift** the SRPC in the opposite direction
- Changes in the NRU shift the LRPC
- The **quantity theory of money** (MV = PQ) states that increases in the money supply lead to inflation and vice versa assuming constant V and Q
- In **MV = PQ**, PQ = nominal GDP
- Government Budget Balance = tax rev. - gov't spending
- Budget deficits get added on to the **government debt**
- Borrowing by the gov't → dLF↑ → rIR↑ → business spending is **crowded out** → this is called the **crowding out effect**
- **Economic Growth**—measured in growth rate of rGDP/time
- **Labor Productivity**—defined by **physical** and **human** capital
- Economic growth is analogous to **shifts in the PPC/LRAS**

Open Economy-International Trade and Finance
Unit 6 ↓

- A country's **balance of payments (BOP)** is a summary of its international trade within 1 year, in terms of the domestic country's current and capital accounts (one -, one +, **add up to 0**)
- **Current account:** tracks exports/imports, includes net exports, invest income (from factors of production), and net transfers
- **Capital account**: tracks ownership of assets/investment abroad and domestically, includes stocks, bonds, and capital
- **Net capital**: outflow = negative, country invests more than other countries in it, inflow = positive, country has more investment in it that it invests
- **Debit**: money going out, **Credit**: money coming in
- **FOREX Market** shows floating **exchange rates** (the value of two currencies relative to each other) and is dependent on tastes, price levels, income, and interest rates
- **Appreciation**: increase in value, **Depreciation**: decrease in value (if one appreciates, other MUST depreciate)
- **Supply of FOREX** = domestic country, **Demand of FOREX** = foreign country
- ↑IR = ↑demand (because of higher rate of returns)

Tips & Tricks
FRQ

- When in doubt, **graph it out!** Keep a sheet of paper near you to take notes, draw graphs, and do basic calculations
- Be sure to **practice the more mathy aspects** of AP Macro (comparative advantage, terms of trade, calculating macro measures (GDP, unemployment, inflation), bank balance sheets, multiplier effect, MV=PQ
- **Assume your answers are correct**—if your answer in part (b) is consistent with your answer in part (a), you'll get the point for (b) regardless of (a), given (b) was correct and consistent.
- **Don't go down the cause and effect rabbit hole**—ex: Supply decreases, meaning price increases, meaning demand does this...