Macroeconomics
50 Essential Questions

Unit 1: Basic Economic Concepts

1. Explain how to show a recession, full employment, and growth on the production possibilities curve.
A recession is a point inside the PPC, full employment is a point on the PPC, and economic growth is when the entire PPC shifts outward to the right.
2. Explain the difference between an output comparative advantage question and an input question.
An output question is when different amounts of goods are made with equal amounts of resources. An input question is when different amounts of resources are used to make the same amount of goods.
3. Explain how to determine if a country has a comparative advantage. To determine if a country has a comparative advantage, compare how much each country gives up when they produce something. The country that has the lower opportunity cost has the comparative advantage.
4. Explain how to determine the terms of trade when two countries specialize. Countries can benefit from trade if they can get goods at a lower opportunity cost then if they produce it on their own. If the amount given up when trading is lower than the opportunity cost then that country benefits from trade.
5. Explain why either price or quantity are indeterminate when both demand and supply change.
A double shift causes a definitive change in either equilibrium price OR quantity. The one that doesn't definitively change is indeterminate because it depends on the severity (size) of the shift.

Unit 2: Economic Indicators and the Business Cycle

6. Explain why transfer payments are not included in Real GDP. GDP measures goods and services produced. Transfer payments are not included because nothing new is purchased or produced.

7. Explain why the official unemployment rate might not reflect true joblessness in an economy.
The official unemployment rate ignores discouraged workers. These are jobless people that have given up looking for work. They are not counted as unemployed because they are not in the labor force.
8. Explain why full employment (or the natural rate of unemployment) is not 0% unemployment.
0% is not possible. The economy will always have some frictional and structural unemployment. Full employment is when there is no cyclical unemployment.
9. Explain why an increase in unexpected inflation helps borrowers. When inflation increases, borrowers pay back loans with dollars that have a lower purchasing power.

10. Explain the difference between the annual inflation rate and the consumer price index (CPI). The inflation rate shows how prices changed compared to last year. The CPI shows how prices changed compared to a base year. Unlike the inflation rate, the CPI is not a percentage. It is an index number.
11. Explain why a recessionary gap, or negative output gap, is not the same as a recession. An official recession is when real GDP is decreasing. A recessionary gap is when the actual real GDP is less than the potential (or full employment) real GDP even if real GDP can be increasing.

Unit 3: National Income and Price Determination

12. Explain why the aggregate demand curve is downward sloping. Higher prices cause spending to decrease. This is demonstrated by the real wealth effect, the interest rate effect, and the exchange rate effect.
13. Explain why the aggregate supply curve is upward sloping. In the short-run, businesses have an incentive to produce more output when prices increase. When there is inflation, businesses can earn more profit in the short-run before the price of labor and resources increase.
14. Explain why the long-run aggregate supply curve is vertical. In the long-run, businesses have no incentive to produce more output when prices increase because resource prices and wages increase proportionately to inflation.
15. Explain how to show a negative supply shock using the aggregate demand and supply model.
A negative supply shock results in a leftward shift in the SRAS causing the price level to increase and the real GDP to decrease.
16. Explain what happens in the long-run when there is a negative output gap and no policy action.
Eventually, resource prices and wages will fall since there is high unemployment. The SRAS will shift rightward returning the economy to full employment real GDP. This is assuming that wages are flexible.
17. Explain what happens in the long-run when there is a positive output gap and no policy action.
Eventually, resource prices and wages will increase since there is high inflation. The SRAS will shift leftward returning the economy to full employment.

18. Explain how government spending will affect the overall economy in the short-run. Government spending increases real GDP and decreases unemployment. The actual increase in real GDP is significantly more than the initial increase in government spending due to the multiplier effect.
19. Explain how a tax cut will affect the overall economy in the short-run. A tax cut increases real GDP and decreases unemployment. It also decreases government tax revenue and moves the government toward a budget deficit.
20. Explain why an increase in the MPS causes the spending multiplier to decrease. When the MPS increase, people save more. This decreases the MPC and the amount people spend.

21. Explain why a tax cut by a certain amount has less of an impact on the economy than an increase in government spending by the same amount. A tax cut has less of an impact on the economy because people save a portion of a tax cut so not all the cut is added to the economy. The entire amount of government spending is added to the economy so it has a greater impact.
22. Explain why progresive income taxes are an example of an automatic stabilizer. Progressive taxes work countercyclically, slowing down or speeding up the economy automatically. When there is a recessionary gap, income taxes automatically fall as people fall into lower tax brackets.

Unit 4: Financial Sector

23. Explain why bond prices and interest rates are inversely related. Bonds are issued with a fixed interest rate. If interest rates increase, people prefer new bonds with higher rates rather than previously issued bonds with lower rates. To sell these previously issued bonds, bond owners must lower the price.
24. Explain why an increase in unexpected inflation causes a decrease in the real interest rate. The nominal interest rate a lender earns can be eroded if there is unexpected inflation. Example, if inflation is 5%, a nominal interest rate of 6% earns only 1% in purchasing power due to inflation.
25. Explain the difference between the money supply and the monetary base. The money supply includes money in circulation and checkable deposits. The monetary base is smaller and includes money in circulation and bank reserves.
26. Explain how money serves as a medium of exchange, a store of value, and a unit of account. Money is used to buy and sell goods and services (medium of exchange), save purchasing power for a later date (store of value), and measure the value of different goods and services (unit of account).
27. Explain why a decrease in the reserve requirement causes the money multiplier to increase. When the reserve requirement decreases, banks are no longer required to hold as much money in reserve. This allows them to offer more loans and increase the money supply at a faster rate.
28. Explain why the demand for money is downward sloping. When the interest rate is high, people prefer to hold less money in cash or in checking accounts and, instead, purchase assets that can earn them these higher interest rates such as bonds.
29. Explain why interest rates and investment are inversely related. Investment is when businesses borrow to expand their business. When interest rates are high, borrowers will borrow less since the cost of the loan is higher. A low interest rate encourages more borrowing since the cost of the loan is lower.
30. Explain how open market operations can increase or decrease the money supply. When the central bank buys previously issued government bonds it allows banks to lend out more money which increases the money supply. The opposite happens when the central bank sells government bonds.
31. Explain why a cash deposit of a certain amount creates less money than a purchase of bonds by the central bank of the same amount. Banks can only lend out a portion of cash deposits so the increase in excess reserves is less than the amount deposited. A bank can lend out all of the money it gets when the central bank buys its bonds since all the funds are added to excess reserves.
32. Explain how an increase in the money supply affects the overall economy. When the money supply increases, the nominal interest rate falls. This increases investment and interest-sensitive consumer spending. This increases real GDP and decreases unemployment.
33. Explain how an increase in deficit spending will cause the real interest rate to increase. When the government borrows, it decreases the supply of loanable funds available to the private sector. This increases the real interest rate and makes it harder for businesses to borrow.
34. Explain why an increase in the savings rate will cause the real interest rate to decrease. More saving increases the supply of loans available. This decreases the real interest rate.

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Unit 5: Long-Run Consequences of Stabilization Policies

35. Explain how monetary policy can be used to fight inflation caused by expansionary fiscal policy.
The central bank can decrease the money supply to increase interest rates and decrease investment and interest-sensitive consumer spending to prevent high inflation caused by expansionary fiscal policy.

36. Explain how to show a recessionary gap, inflationary gap, and full employment on the Phillips curve.
A recessionary gap is a point down and to the right on the SRPC, an inflationary gap is up and to the left on the SRPC, and full employment is in the middle where the SRPC and LRPC intersect.

37. Explain why the long-run Phillips curve is vertical. There is no tradeoff between inflation and unemployment in the long-run. In the long-run, the economy will always be at the natural rate of unemployment (NRU).

38. Explain how to show a negative supply shock using the Phillips curve. A negative supply shock results in a rightward shift in the SRPC showing an increase in both inflation and unemployment.

39. Explain why an increase in the money supply will increase nominal GDP, but not real GDP. The quantity theory of money states that an increase in the money supply doesn't increase the amount of goods/services that can be made. Without more investment, more money only causes more inflation.

40. Explain the difference between a budget deficit and the national debt. A budget deficit is an annual measure showing how much spending outpaced tax revenue in a year. The national debt is the cumulation of all budget deficits over time.

41. Explain why deficit spending can result in crowding out. When the government borrows it decreases the supply of loanable funds available for private investment. This increases the real interest rate and decreases the number of loans taken by businesses.

42. Explain why crowding out results in less economic growth in the long-run. Crowding out causes higher interest rates which decreases investment. Less investment results in less capital stocks and less growth over time.

43. Explain how to show economic growth using the aggregate demand and supply model. Economic growth is shown by a rightward shift in the LRAS. This means that more output can sustainably be produced than before.

44. Explain why an increase in physical capital or human capital can result in economic growth.
More physical capital means that businesses can permanently produce more output than before. More human capital makes workers more productive since they are smarter and more educated.

45. Explain how government spending can result in economic growth. Government spending on infrastructure results in more growth since it increases productivity by improving transportation and production. Government spending on education can increase human capital making workers better.

Unit 6: Open Economy- International Trade and Finance

46. Explain the difference between the current account and the capital and financial account. The current account measures the sale and purchase of goods and services between countries. The CFA measures the sale and purchase of financial assets like currency, bonds, and stocks.

47. Explain why two currencies can't appreciate relative to each other at the same time. The exchange rates of different currencies are reciprocals of each other. When currency A appreciates relative to currency B, then currency B must depreciate relative to currency A.

48. Explain why appreciation of the currency results in a decrease in net exports for the country. When a country's currency appreciates, it becomes more expensive for foreigners. These foreigners purchase fewer goods and services causing net exports to decrease.

49. Explain why inflation results in both a decrease in demand and an increase in supply for a country's currency..
Inflation causes foreigners to demand less of the country's goods so the demand for the currency falls. Inflation also causes citizens to want relatively cheap foreign goods which increases the supply of the currency.

50. Explain why an increase in real interest rate will increase financial capital inflow. When real interest rates increase, foreigners will want more of that country's currency so they can purchase interest-bearing assets and earn a high rate of return.