**Prep Questions for the Final**
ECON 4673
Dr. Keen

**Note**: This list of prep questions only includes the material since Exam #3. When studying for the Final, you should also review the prep questions from Exam #1, Exam #2, and Exam #3.

1. Describe the two ways monetary policy can respond to a negative aggregate demand shock. What are the short-run and long-run effects of each policy? Use an AD/AS graph for each type of monetary policy to support your answer. What do these graphs say about the tradeoff between output and inflation?

2. Describe the two ways monetary policy can respond to a negative, long-run aggregate supply shock. What are the short-run and long-run effects of each policy? Use an AD/AS graph for each type of monetary policy to support your answer. What do these graphs say about the tradeoff between output and inflation?

3. Describe the three ways monetary policy can respond to a negative, short-run aggregate supply shock. What are the short-run and long-run effects of each policy? Use an AD/AS graph for each type of monetary policy to support your answer. What do these graphs say about the tradeoff between output and inflation?

4. Briefly explain the difference between activist's and nonactivist's monetary policy.

5. Name and briefly describe the four lags that prevent the economy from immediately self-correcting.

6. What are cost-push shocks, and what are some potential causes? How can activist's monetary policy cause inflation when responding to a cost-push shock? Use an AD/AS graph to support your answer.

7. What are demand-pull shocks, and what is a potential cause? How can activist's monetary policy cause inflation with a demand-pull shock? Use an AD/AS graph to support your answer.

8. Suppose the IS curve, the monetary policy rule, and the Fisher equation are as follows:

$$Y = \frac{\bar{C} + \bar{I} + \bar{G} + \overline{NX} - d \times \bar{f} - MPC \times \bar{T}}{1 - MPC} - \frac{d + x}{1 - MPC} \times r$$
$$R = \bar{r} + \pi + \theta \times (\pi - \pi^*)$$
$$R = r + \pi.$$

   a. Derive the MP curve equation when $R > 0$.
   b. Derive the MP curve equation when $R = 0$.
   c. Graph the MP curve (include both the times when $R > 0$ and $R = 0$).
   d. Derive the AD curve equation when $R > 0$.
   e. Derive the AD curve equation when $R = 0$.
   f. Graph the AD curve (include both the times when $R > 0$ and $R = 0$).

9. Consider an economy where the AD curve intersects the LRAS curve in two places (once where R > 0 and once where R = 0) and the AD curve at R=0 is steeper than the AS supply curve. In each of the situations below, use an AD/AS graph to show whether the economy returns to $Y^P$ in the long run.

   a. Suppose $Y < Y^P$ and R = 0
   b. Suppose $Y > Y^P$ and R = 0

10. Consider an economy where the AD curve intersects the LRAS curve in two places (once where R > 0 and once where R = 0) and the AD curve at R=0 is steeper than the AS supply curve. Initially assume $Y < Y^P$ and R=0. In each of the situations below, use an AD/AS graph to show how unconventional monetary policy can move output back to its potential.

    a. Suppose the central bank provides liquidity to financial markets to reduce financial frictions ($\bar{f}\downarrow$).
    b. Suppose the central bank provides forward guidance to raise inflation expectations.

11. What is the Lucas Critique, and why is it important for macroeconomic models?

12. Monetary policy can use rules or discretion. What are two types of monetary policy rules the central bank can use? What are two advantages of using monetary policy rules? What does discretion imply for the conduct of monetary policy, and what does it imply about the commitment to future policy? What are four advantages of discretion in monetary policy? What is <u>constrained discretion</u>?

13. What is a nominal anchor? When is monetary policy said to have credibility? What are two benefits of a credible nominal anchor?

14. Use an AD/AS graph to show how a central bank's credibility helps stabilize inflation after a positive aggregate demand shock.

15. Use an AD/AS graph to show how a central bank's credibility helps stabilize inflation and output after a negative aggregate demand shock.

16. Use an AD/AS graph to show how a central bank's credibility helps stabilize inflation and output after a negative short-run aggregate supply shock.

17. Use an AD/AS graph to show how a central bank's credibility helps stabilize the economy after disinflation.

18. What is nominal GDP targeting? What are its advantages and its disadvantages?

19. Name and describe the four ways monetary policy can impact the economy via the asset price channel.

20. Name and describe the five ways monetary policy can impact the economy via the credit view channel.

21. What are the three reasons credit channels are important to the monetary transmission mechanism?

22. What are the four lessons for monetary policy discussed on the last day of class?