**Review questions**

*The core AD-AS model / Self-correcting mechanism / Inflation theory*

1. Describe the adjustment toward equilibrium under the Keynesian cross model. What is the role of planned and unplanned inventory in the analysis?
2. Discuss and explain about the concept of multiplier.
3. What is the IS curve? Explain the underlying intuition for the IS relation.
4. What are the factors that determine the slope of IS curve? Should the IS curve be steeper or flatter if both private consumption and private investment are more responsive to the interest rate?
5. An increase in government spending would cause (a) a movement along the IS curve or (b) an outward shift of the IS curve. Why?
6. What determine the size of a *horizontal shift* of the IS curve? (Hint: you may think about the exogenous increase/decrease in autonomous expenditure.) Does the size of a horizontal shift have any relationships with slope of the IS curve? Why or why not? Explain.
7. What is the LM curve? What determine the slope of LM curve?
8. What are the factors that determine the slope of LM curve? Should the LM curve be steeper or flatter if demand for money sensitively responds to market interest rate?
9. A systemic panic in financial markets would cause (a) a movement along the LM curve or (b) an upward shift of the LM curve. Why?
10. Would it the effect of fiscal policy (either tax cut or the increase in government spending) be more pronounced (stronger) under the IS-LM model than under the traditional Keynesian cross? Why?
11. Why does the aggregate demand curve have a downward sloping shape in general price level? Explain the intuition. Link the analysis to your IS-LM model.
12. Does the increase in money supply cause (a) a movement along the aggregate demand curve or (b) an upward increase in aggregate demand curve? Explain the underlying mechanisms for your answer. Link the analysis to your IS-LM model.
13. Explain the meaning of these terms. Make sure you understand their implications for business cycles properties, and how they are relevant for explaining the key business cycles stylized-facts.
    a. One-period Wage contract v.s. Multi-period Wage contract
        i. Real-wage contracting
        ii. Nominal-wage contracting
        iii. Nominal-wage contracting with full-indexation.
    b. *Natural-level variable*
        i. Natural level of employment
        ii. Natural level of unemployment rate
        iii. Natural level of output
        iv. Potential output
        v. Output gap
        vi. Unemployment gap
    c. Nominal price rigidities and price stickiness
        i. Sectoral price rigidities

ii. Frequency of price adjustments
iii. Unsynchronized adjust in nominal prices
d. Gradual adjustment theory
e. Output and inflation persistence

14. *True/False:*
    a) Under the rational expectation, change in money supply is always neutral.
    b) Policymaker can exploit the trade-off between inflation and unemployment.
15. Guided by our economic theory, how do we practically measure the natural level of output under the absence of real-wage contracting?
16. The impact of demand/supply shocks
    a) Temporary shocks v.s. Permanent shocks
    b) Anticipated v.s. unanticipated shocks? Does it matter to the behavioral response of key economic variables in our model? Transitory outcome? Adjustment?
17. How did the economist explain the inflation-unemployment observation proposed by A.W. Phillips?
18. Why did we see the unstable macroeconomic outcomes during the 70s? Origin? How did things get bad? What did we (policymakers and academic economists) learn then?

*Open-economy macroeconomics*

1. Explain the difference between a closed economy and an open economy. Explain also how the pursuit of internal equilibrium will be different between the two types of economies.

2. Consider the IS-LM-BP model of an open economy with a constant price level, perfect asset substitutability, and perfect capital mobility. The economy is initially in both internal and external equilibrium.

a. Explain why the BP curve is a horizontal line at i =iF, where i is the domestic nominal interest rate and iF is the foreign nominal interest rate.

b. Define the internal equilibrium and external equilibrium of the economy, respectively.

3. From question 2, suppose now that the domestic economy decides to reduce its money supply.

a. What are the initial effects of this monetary policy on the goods market, the money market, the foreign exchange market, and the balance of payments of the domestic economy? Which curve(s) will shift?

b. What is the adjustment mechanism under a fixed exchange rate regime? Illustrate and explain which curve(s) will shift during the adjustment, and then compare the new equilibrium with the initial equilibrium.

c. What is the adjustment mechanism under a flexible exchange rate regime? Illustrate and explain which curve(s) will shift during the adjustment, and then compare the new equilibrium with the initial equilibrium.

4. From question 2, suppose now that the domestic government decides to increase the government spending.

a. What are the initial effects of this fiscal policy on the goods market, the money market, the foreign exchange market, and the balance of payments of the domestic economy? Which curve(s) will shift?

b. What is the adjustment mechanism under a fixed exchange rate regime? Illustrate and explain which curve(s) will shift during the adjustment, and then compare the new equilibrium with the initial equilibrium.

c. What is the adjustment mechanism under a flexible exchange rate regime? Illustrate and explain which curve(s) will shift during the adjustment, and then compare the new equilibrium with the initial equilibrium.

5. If a country has a surplus balance of payments, what will be the appropriate government policy to restore the balance of payments back to equilibrium? What effects might this have on the country's income?

6. Imagine that we have a country with imperfect capital mobility and flexible exchange rate. What will happen with domestic income and interest rate if there is a decrease in foreign interest rate? Explain your answer.

7. Show graphically using the Mundell-Fleming model what impact will have an introduction of import restrictions (that improve net exports exogenously, irrespective of the exchange rate). Assume that we have a flexible exchange rate and a perfect capital mobility. Will the introduction of import restrictions improve net exports in equilibrium, as argued by many politicians?

8. Suppose that the government of the small open economy with perfect capital mobility and flexible exchange rate increases lump taxes. Please, compare the impact of such a policy on income, private savings, investment, real interest rate, trade balance and real exchange rate.

9. The small economy of Rokitkowo, due to outstanding economic policy run by president Rokitek stays at full employment. After another sleepless night, president Rokitek has decided to change the structure of demand in order to increase investment. What should be the mix of fiscal and monetary policy if there is no international mobility of capital and the economy has fixed exchange rates. Show your results drawing the necessary diagram.

10. What will be the impact of revaluation of domestic currency if we have an economy with imperfect capital mobility and fixed exchange rates? Would be the impact larger if we had a perfect capital mobility in this case?

11. Imagine that these days USA, the biggest trade partner of Thailand, is suffering from a deep economic slowdown. How would it influence Thai economy if we had to maintain the fixed exchange rates (there is a perfect capital mobility)? Show the necessary diagram and provide the written justification.

12. The ungrateful citizens of Kalaland have decided to elect Mr. Lazyman as a new president. As a result, the government started to increase its spending and ran huge budget deficits. Yet, the time of economic slowdown arrived and there was a necessity to cut public spending sharply. How would it influence the economy of Kalaland if, for some reasons, Kalaland was forced to keep a fixed exchange rates? Assume that we start from equilibrium and there is a perfect capital mobility.

13. Applying the Mundell-Fleming model analyse the impact on domestic income, interest rate, CA and KA of the following events:

(a) an increase of foreign interest rate;

(b) a fall of foreign demand on domestic goods.

Provide an analysis for two different countries: - country A with fixed exchange rate and perfect capital mobility - country B with flexible exchange rate and perfect capital mobility

14. (Transmission under interdependence economy: Spillover effect)

14.1) Assume that the US government decides to increase its public spending. Use the IS-LM / AD-AS model to explain the dynamic of US macroeconomic variables followed from the spending program.

14.2) Suppose that Carlaland is a small open economy. Following the results in (14.1), use the Mundell-Fleming model and analyze the spillover effects of US policy on domestic income and interest rate of Carlaland. Suppose that Carlaland faces perfect capital mobility under the flexible exchange rate regime? What would happen with exchange rate and domestic exports? Explain.