Flashcard for your own review!

1. What is business cycles?:

    - Movement of real GDP around its trend.

    - Trend is determined by long-term facto, such as the productivity growth.

2. Why cause the cycle?

    - Shocks: source/origin of fluctuations. Many types of possible shocks that hit the economy!

3. What do we aim to understand in business cycles studies?

Shock-propagating mechanism: Understanding how macroeconomic variable reacts to shock, learning to understand about the nature of response, getting sense about when shock is going to create a big mess for cleaning up.

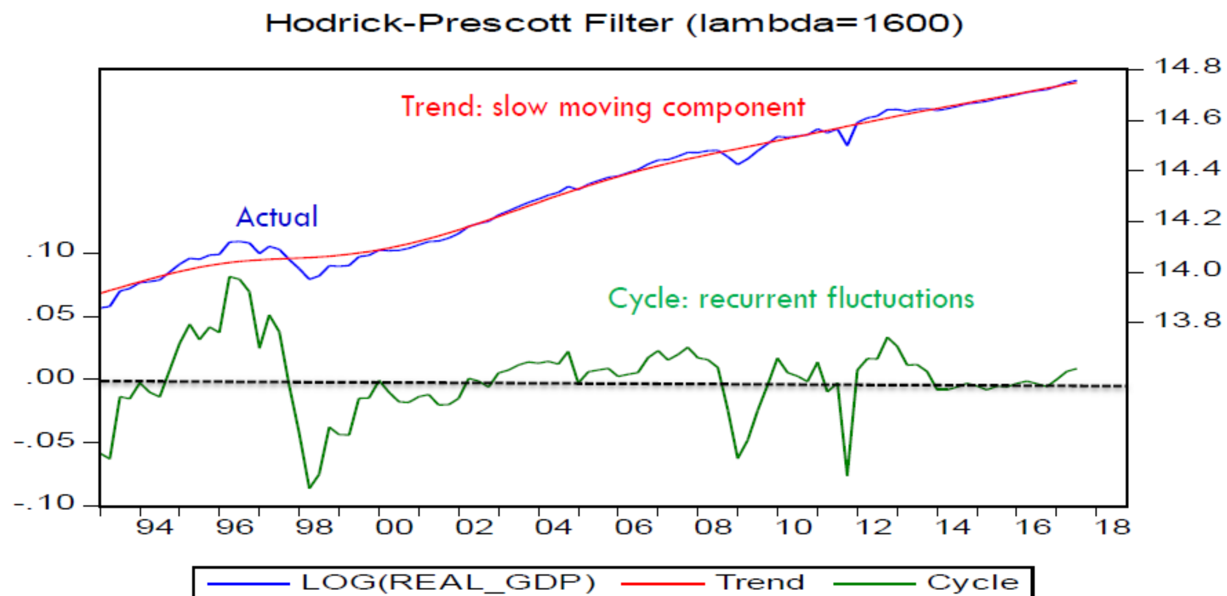
Identifying shocks that largely matter, or frequently hit the economy. This is to gain some insights about how to contain the fluctuations and tame the cycle.

4. How do economists conceptualize the business cycles properties?

Using statistical descriptions: standard deviation, covariance, correlation (What is the difference between the last two?).

Pro-cyclical, Counter-cyclical and Acyclical variable: describe the correlation behavior between variable X and real GDP.

5. Below figure shows the component of real GDP: trend and cycles. “Actual” refers to seasonally-adjusted real GDP, measured in the log scale. Can you make sense about what cause the cycles over different periods in the figure?



Keynesian business cycles: closed economy model

6. **Keynesian business cycles**: Class of models used to explain the business cycles. Relying on the key assumption “nominal rigidities”.

7. **Three variant versions:** Keynesian cross, IS-LM and AD-AS model. (You should be able to tell the similarities and differences among the three.)

Keynesian cross: fixed price, fixed interest rate

IS-LM: fixed price, adjustable interest rate

AD-AS: adjustable price, adjustable interest rate, but “nominal” wage is pre-determined under contractual agreement. (It could be a variable scheme or a fixed constant scheme. But after all, this is called “nominal” wage rigidities.)

8. Different types of shocks hit the economy differently – refer to the shock-propagating mechanism. Many effects occur along the adjustment toward new equilibrium.

9. Identify the situation or the structure of economy that shock can hit hard, what determine the size of the impact of shock. Any pattern or characteristic of the economy that will be prone to have generated high volatilities. Degree of the rigidities?

Open-economy concept

10. **Open-economy model:** linking our economy to the world, through trade and fiancé. This allows us to understand how we respond to shock under open-economy environment. More importantly, we gain some insights about how external factors/shocks affect country, and generate business cycles.

12**. IS-LM-BP:** three line used to capture the interaction among three markets, namely, (i) goods&service market, (ii) money market, and (iii) forex market (balance of payments)

13. **Internal v.s. external v.s. general equilbirum:** three different notions of equilibrium. The last occur when all three lines intersect.

14. **Disequilibrium and Equilibrium:** Require different process. This depends on the exchange rate regime. Under fixed exchange rate, forex intervention and money supply will be responsible for the adjustment. Under flexible exchange rate, the adjustment will occur through the appreciation/depreciation of domestic currency.

13. **Mundell-Fleming model:** open-economy model that assumes perfect capital mobility. Capital account dominates the current account; the BOP is determined by the position of capital account.

14. **Shock-insulation:** the structure or characteristic of economy that limits the impact of shocks. Might be due to the structure of economy or because of the policy designed so as to cushion the impact of shocks.

15. **Shock-amplification:** the structure or characteristic of economy in which shock generates large impact.

16. **Policy effectiveness:** policy can be used to direct the output towards the desirable level. Under fixed exchange rate, the higher degree of capital mobility, the more effective fiscal policy. Under flexible exchange rate, the higher degree of capital mobility, the more effective monetary policy.

17. **Financial sterilization:** forex intervention that is accompanied by the operation to offset the change of money supply

18. Impossibility trinity: three conditions that cannot be simultaneously achieved; controlling interest rate, capital mobility and pegging exchange rate. This policy mismanagement often sows the seeds of financial crisis.