

Multiple choice questions

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Keynes → In regards to the functioning of macroeconomics
* level of output in an economy is determined by the demand for goods.

Diff between macroeconomics + microeconomics →
Microeconomics studies individual decisions → macro economy in whole

Main focus → determination of output + the impact of fiscal + monetary policy on the level of output

Keynes → relationship between output + aggregate demand →
positive → if demand increases output will increase

② GDP ⇒ total value of all final goods within the border of a country → include exports → exclude imports during a specific time period by citizens + foreigners in the country

Economic growth → when the total production of goods + services in an economy increases.

Nominal GDP → sum of all the quantities of final goods & services produced multiplied by their current price.

Real GDP → measure of the GDP as base price in a current year rather than current prices.

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Real GDP/per capita \rightarrow widely used as a measure of a country's economic wealth / wellbeing.

Balance of pmt \rightarrow between reporting country + rest of the world \rightarrow include current account, capital transfer account, financial account, unrecorded transactions + official reserve account between SA households, firms, foreign households, firms + governments

Spending by households, private firms and Government on residential + non residential Capital Goods are - Gross Capital formation

NB make sure when asked for GDP is the FINAL goods \rightarrow if adding all goods it will overstate the value of production in the country/economy.

overall balance of payments position in the balance of payments is reflected by the change in foreign reserves

Final Consumption expenditure by the government is made up of spending on goods + services including the purchase of capital goods but excluding transfer payments + interest on debt

3

Consumption

3 Final expenditure by government \rightarrow expenditure on final goods + services (excludes pension, interest on debt, ~~purchase of capital goods~~) Excludes transfer payments, includes purchase of capital goods

Gross Domestic Expenditure \rightarrow includes imports, but excludes exports \rightarrow total expenditure on goods in the country

Expenditure on GDP \rightarrow excludes imports, includes exports

Relationship between consumption + income is positive and the increase in consumption will be less than the increase in income

Increase in income will increase consumer spending (positive relationship)

C_{Yb} Induced consumption \rightarrow influenced by the level of disposable income

C₀ Autonomous consumption \rightarrow NOT influenced by the level of income

Autonomous (exogenous) variable \rightarrow not determined by the level of income or production BUT is determined by exogenous factors such as business confidence, regulations, political etc.

Autonomous consumption \rightarrow prior savings/inheritance (Vertical axis on the graph does not change)

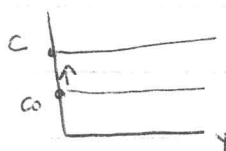
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Expansionary fiscal policy $\rightarrow G \uparrow / T \downarrow$ to increase demand.

Contractionary fiscal policy $\rightarrow G \downarrow / T \uparrow$ to decrease demand/
output \rightarrow "cool down"

Induced consumption \rightarrow affected by level of disposal income ($c \cdot Y_d$)

Increase in autonomous spending C_0 will shift the vertical part
upwards



change in the level of ~~output~~^{consumption} will cause a change in output and income/
demand for goods

Marginal propensity to consume shows the relationship between a change
in the level of income and consumption.

Financial investment \rightarrow money on CD by bank

Real investment \rightarrow spending on capital goods to increase production +
future revenue.

consumption function \rightarrow positive slope + the induced consumption is
less ~~than~~ than the change in income.

increase in marginal propensity to consume will make the slope of
consumption function + demand for goods steeper

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→ Increase in investment will cause the demand for goods function to shift upwards.

→ equilibrium = multiplier \times Autonomous spending.

→ full employment can be reached by a change in either autonomous spending and/or the marginal propensity to consume.

④ → money used for transactions includes coins, notes + checkable deposits

→ demand for money in the economy depends on the interest rate + level of income

- Exogenously determined money supply determines that money supply is determined by the central bank.

→ increase in money demand will shift the M_d curve to the right.

→ expansionary monetary policy involves the buying of bonds on the open market by the central bank to increase the supply of money + the interest rate will decrease.

→ decrease of income on the financial market

$\rightarrow Y \downarrow \rightarrow M_d \downarrow \rightarrow P_b \uparrow \rightarrow i \downarrow$

(6)

Demand for money function \rightarrow changes in interest will cause movements along the M_d curve + a change in income will cause a shift of the M_d curve

Money supply curve is a vertical line.

- \rightarrow Central Bank \rightarrow decrease money supply \rightarrow sell Treasury bills on the open market + the result of a lower money supply will shift the M_S curve to the left. (increase supply bonds \rightarrow bond prices \downarrow \rightarrow interest \uparrow)
- \rightarrow Decrease of money supply \rightarrow $S_B \uparrow$ $P_B \downarrow$ \rightarrow $i \uparrow$
- \rightarrow relationship between the rate of interest + the level of investment \rightarrow higher the rate of interest, the higher the cost of borrowing + the lower the level of investment
- \rightarrow investment \rightarrow internal rate of return is less than the market rate of interest, investment should NOT be undertaken.
- \rightarrow Demand for money function has a positive relation with the level of income + a negative relation with the rate of interest.
- \rightarrow exogenous money supply is one where the money supply curve is perfectly interest inelastic.

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→ increase in the rate of interest on the equilibrium level of income in the goods market will be investment decreases, demand decreases, income decreases

→ Demand for money

↳ increase in interest rate → decreases money demanded

↳ increase in income → increase demand for money for transaction purposes

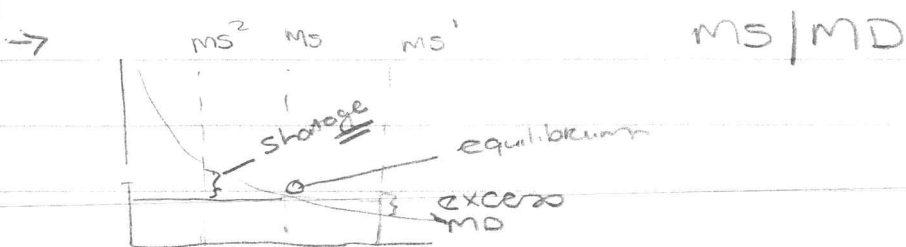
↳ increase in demand for money shifts MD curve right

→ Decrease in income with a simultaneous contractory open market operation by the central bank will →

Shift of Demand for money left → money supply to the right

→ calculate financial wealth of a person → Balance on checking account, cash, bonds, shares, value of his/her house + paintings

→ income increases → demand for money increases + the MD curve shifts to the right.



- Rightward shift of MSupply Curve → Contractionary monetary policy → central bank sells Bills/Bonds on the open market to decrease money supply + the interest rate increases
- Decrease in income with a simultaneous expansionary open market operation by the central bank shifts the Demand for money curve to the left + the Money supply to the right the equilibrium interest rate is lower.
- In the financial Market an increase in the level of income will cause both the demand for money M_d + interest rate to rise
- Decrease in real money supply will shift the LM Curve to the left or upwards
- Demand for money → changes in rate of interest will cause movement along the M_d Curve + changes in income will cause a shift of the M_d Curve.
- Decrease of money supply → increase Bond Sales → leads to $P_B \downarrow$ Price of bonds coming down + interest increases $SBR - P_B \downarrow - i \uparrow$.
- Relationship between demand for money + interest is negative
- decrease of the level of income will cause the demand of money curve to shift downwards

→ Decrease of money supply → increase bond supply → cause bond prices to fall + interest to rise

⇒ When the Central bank sells bonds/Treasury bills will cause the money supply to decrease.

→ demand determined money supply → no independent money supply curve / same as the money demand curve + interest is controlled by the central bank

→ Decrease in money supply indicates a contractionary money supply policy is adopted.

→ exogenous Money Supply curve → Increase in interest rate will leave the money supply unchanged

→ exogenous money supply indicates that the money supply is not influenced by interest rate - perfectly interest inelastic

→ Sale of domestic financial assets such as Treasury bills by the central bank to influence the quantity of money + the interest rate is ~~at the~~ → open market operations

→ impact of an increase of income in the financial market is
 $Y \uparrow \Rightarrow M_d \uparrow \Rightarrow P_b \downarrow \Rightarrow i \uparrow$

→ Interest rate decreases it will cause the upward movement on the demand for money curve + the quantity of money demanded will decrease

⑤ Decrease in Government Spending causes the IS Curve to shift to the left + implies that @ each + every interest rate, the demand for goods + the equilibrium level of income is lower.

→ IS Curve → change in interest will cause a movement along the IS Curve + a change in any autonomous variable will cause a shift of the IS Curve.

→ IS / LM Model → investment spending is determined by
 ↳ interest rate
 ↳ level of output.

→ Consumption + investment is a positive function of output.

→ Between interest + investment is a negative relationship.

→ Business confidence + investment subsidies will shift the IS Curve.

→ Financial market - demand for money increases as the level of output increases since people need more money for transactions.

Decrease of output on the financial market

$$Y \downarrow \rightarrow M_d \downarrow \rightarrow i \downarrow$$

LM Curve \rightarrow combinations of interest rates + income levels where the financial market is in equilibrium.

\rightarrow Represents a positive relation between interest rate + level of income.

Derivation of LM Curve $\rightarrow Y \downarrow \rightarrow M_d \downarrow - i \downarrow$

\rightarrow Change in money supply shifts the LM Curve.

\rightarrow Increase in the nominal money supply causes the LM curve to shift to the right + interest decreases. As interest decreases investment spending increases + a movement along the IS curve takes place.

\rightarrow Increase in Government spending shifts the IS Curve to the right, interest level rises + the level of output increases

\rightarrow Decrease in money supply - shifts the LM Curve to the left + the interest rate rises + the level of output decreases

IS Curve \rightarrow Increase in interest rate \rightarrow decrease in investment causes total spending + income to decrease
 \rightarrow any point on IS Curve \rightarrow equilibrium in the goods market
 \rightarrow decrease in interest rate downward slope movement on IS Curve

NB Increase in interest rate does NOT cause consumption spending to decrease.

- \rightarrow Increase in money supply shifts LM Curve rightwards/down
- \rightarrow Decrease in Money Supply shifts the LM Curve to the left + the interest rises + level of output falls
- \rightarrow LM Curve increase in demand for money DOES NOT lead to an increase in supply of money.
- \rightarrow Contractionary money policy \rightarrow decrease output + increase the interest rate.
- \rightarrow Decrease in Money Supply will shift the LM Curve left and upwards
- \rightarrow decrease the budget deficit without decreasing level of output \rightarrow Contractionary fiscal \downarrow Government spending \uparrow taxes
 \rightarrow expansionary monetary \uparrow money supply

IS - LM Model \rightarrow decrease in autonomous spending will cause the IS Curve to shift to the left or downwards, resulting in a lower level of income + rate of interest

Positive slope of LM Curve implies that
 $Y \uparrow - M \uparrow \Rightarrow i \uparrow$

LM Curve represents positive relation between output + interest rate.

\rightarrow Monetary - fiscal policy mix can mean that using the right mix \geq policies can be used in opposite directions

exogenous - factor given not determined within the model.

FM
 Goods
 market

Contractionary fiscal policy $Y \downarrow \Rightarrow M \downarrow \Rightarrow i \downarrow$
 Contractionary Monetary policy $\rightarrow I \downarrow - Z \downarrow - Y \downarrow$

⑥ Labor force

Labor force participation rate is expressed as a % of the economically active population \rightarrow % of the potential labor force.

- \rightarrow where real wage implied by wage setting is equal to the real wage implied by price setting, it is the natural rate of employment.
- \rightarrow Structural unemployment.
- \hookrightarrow mismatch between qualifications / job requirements
 - \hookrightarrow lack of education / training
 - \hookrightarrow changing of production methods / techniques
 - \hookrightarrow foreign competition
- \rightarrow
- \rightarrow Increase in nominal wage demands of labour can be caused by: higher expected price level / Lower level of unemployment
- \rightarrow Increase in the natural rate of unemployment \rightarrow increase in mark up by firms
- \rightarrow increase in the bargaining position by workers due to labor market legislation
- \rightarrow Decrease in output will cause the level of unemployment to increase \rightarrow causes a decline in bargaining power + result in a lower nominal wage

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increase in output

$$Y \uparrow \rightarrow N \uparrow \rightarrow u \downarrow \rightarrow W \uparrow$$

decrease level of employment weakens the bargaining power of the employer.

$$\ln W = P + f(u, z)$$

z = includes minimum wage,
labor ~~laws~~ laws
unemployment benefits

P = price

u = unemployment

→ if the price level increases → the nominal wage will increase by the same %

→ increase in output in the labor market will cause the rate of unemployment to decrease + increase the bargaining power of the worker

$$Y \uparrow \rightarrow u \downarrow \rightarrow P \uparrow$$

→ natural level of unemployment increase when bargaining position improved

- * increase benefits - unemployment
- * increase in markup by firms