Discussion Handout #9 | **TA: John Stromme**
Econ 102 | UW Madison, Fall 2016
Prof. Eudey | Date: 11/03/16

John's Tips for Exam Review

1. Do all of the old exams posted on Learn@UW
   - Don't just look at the answer keys!! Actually try to take the exam.
   - Make your cheat sheet first, and see how well it helps you when you do the old exams.
2. Check out the 'Exam content' and 'FAQ' section on Learn@UW
3. **Extra Office hours:** 2:30-5:00pm Wednesday 11/9, SSCI 7481

Goals for this session

- Present Value Calculation
- Volatility
- Financial Intermediary Malfunction (Cause of housing crisis, and government response)

Vocab/Definitions

- Marginal Product of Capital (MPK)
- Q-theory
- Moral Hazard
- Collateralized Debt Obligation (CDO)
- Morgage Backed Security (MBS)
- Credit Default Swap

Problems

1. You buy a 1 year bond with face value of \$105 for \$100. What is the implied prevailing interest rate?

   There is an exogenous shock which causes the prevailing interest rate to change to 3%. What is the present value of your bond? How much could you sell it for on the secondary market?
2. Consumption is ∼70% of GDP, Investment is ∼17%. Which category has a bigger effect on fluctuations to GDP during business cycles?
3. Investment spending is **(pro-cyclical/counter-cyclical)**.
4. Financial Malfunction and the Great Recession:

- Prelude: What is a simple example of when individuals are acting in the best interest, but it is bad for the group as a whole?
- Who are the relevant 'actors' in the financial crisis?
- What were the incentives of each of these 'actors'? What were they doing in the lead up to the housing crisis?
- Why did these financial markets malfunction?

5. Keynesian vs. Neoclassical and the Great Recession

   (a) What aspects of the great recession seem most like
   - Classical Business Cycles?
   - Keynesian Business Cycles?

   (b) Fiscal policy response
   - Classical fiscal policy response?
   - Keynesian fiscal policy response?