Intro to macroeconomics

Rush

October 2014

We are moving from micro to macro

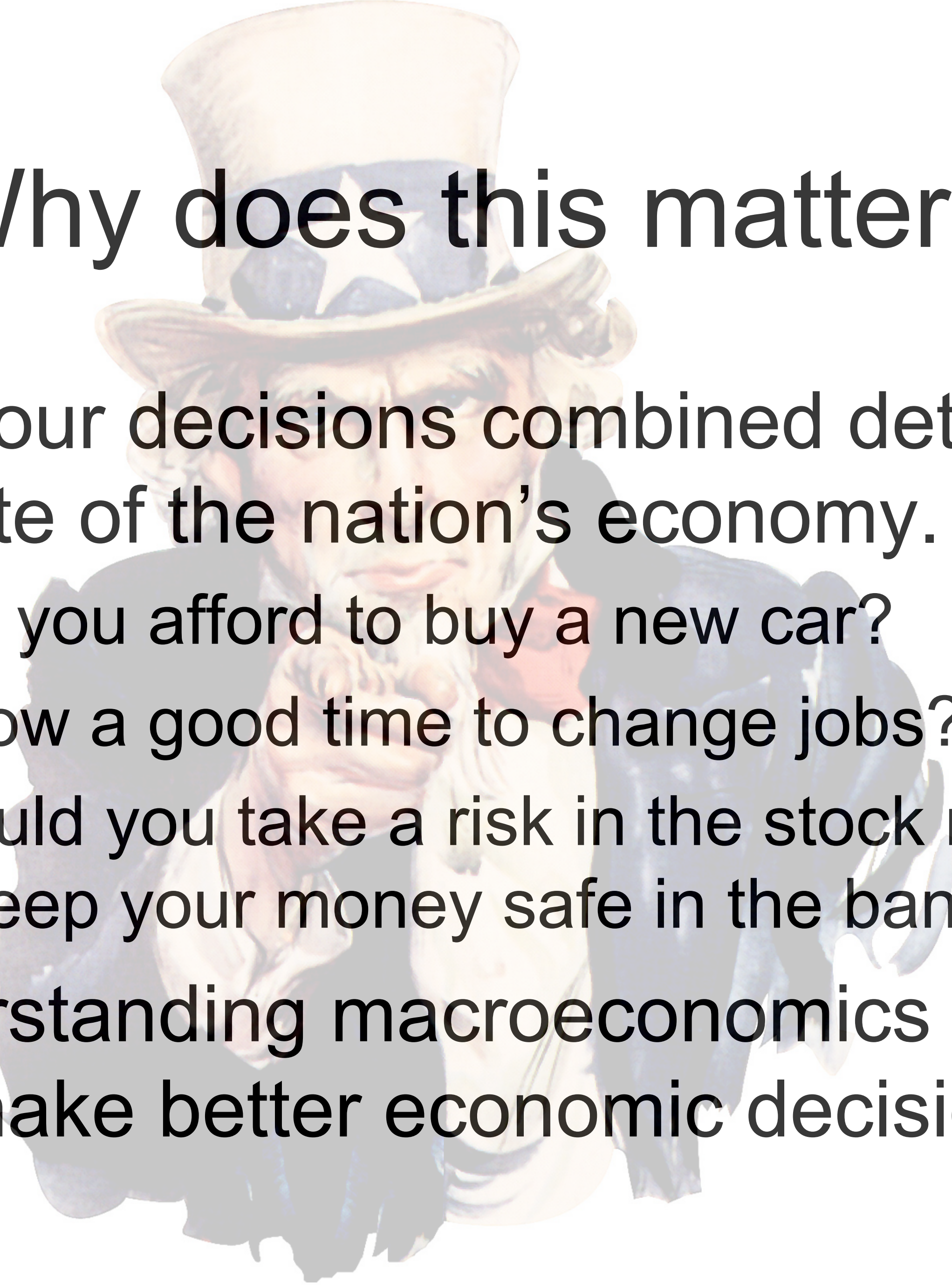
- Micro means small.
- Macro means big.

What is microeconomics?

- Microeconomics is the study of SPECIFIC markets and the behavior of INDIVIDUAL decision-making units such as consumers and firms.

What is macroeconomics?

- Macroeconomics is the study
  of the economy as a WHOLE:
  many consumers, many firms,
  the general price level of the economy,
  total demand for goods and services,
  total output produced in the economy,
  total employment, total investment,
  total exports and imports, etc.



Why does this matter?

- All of our decisions combined determine the fate of the nation's economy.
  - Can you afford to buy a new car?
  - Is now a good time to change jobs?
  - Should you take a risk in the stock market or keep your money safe in the bank?
- Understanding macroeconomics helps you make better economic decisions!

Macroeconomic goals?

- Full employment
- Stable or gently rising price level
- Economic growth
- Equitable distribution of income
- External balance in trade

What is GDP?

- GDP is the market value of all final goods and services produced within a nation in a given time period.
  - Must be final rather than intermediate.
  - Must be produced during the time period, regardless of when it is sold.
  - Must be produced within the nation's borders.

Calculating GDP

- Economists often calculate GDP using the expenditures approach:

  $C + I + G + (X - M)$

  C is consumption spending,
  I is investment spending by business,
  G is government spending, and
  X – M is net exports

Two types of GDP

- Nominal
- Real

- Real GDP is nominal GDP adjusted for changes in prices. Real GDP provides a more accurate measure of economic performance.

What GDP does not measure

- Nonmarket activities (home childcare or performing one’s own home repairs)
- Underground economy (market activities that go unreported because they are illegal or because those involved want to avoid taxation)
- Quality of life (what are we spending our money on?)

What is the business cycle?

- The business cycle is a series of periods of expanding and contracting economic activity, measured by increases or decreases in real GDP. The business cycle has four stages:
  - Expansion
  - Peak
  - Contraction
  - Trough

What is the business cycle?

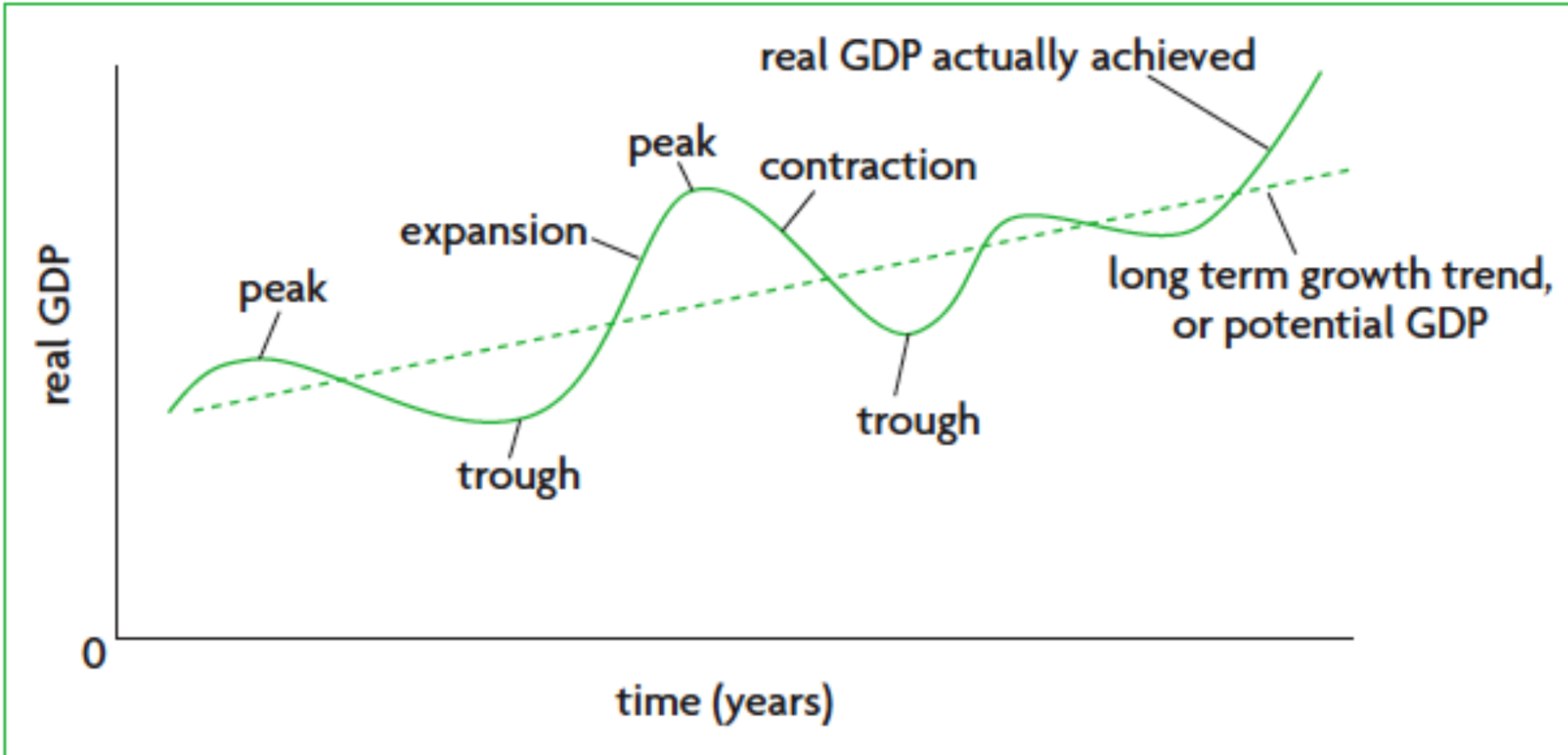


Figure 8.4 The business cycle

Biz cycle: Expansion

- In the expansion phase, real GDP grows from a low point, or trough. The expansion is a period of economic growth.
  - Jobs are relatively easy to find.
  - More and more resources are needed, so prices tend to rise.

Biz cycle: Peak

- The peak is the point at which real GDP is the highest.
  - As prices rise and resources tighten, businesses become less profitable. From that point on, real GDP declines as businesses curtail production.

Biz cycle: Contraction

- The contraction phase begins after the peak. As producers cut back, resources become less scarce and prices tend to stabilize or fall.
  - Unemployment rises because producers produce less.
  - If the contraction lasts two or more quarters (six or more months), it is a recession.
  - A longer contraction may be a depression.

Biz cycle: Trough

- The trough is the point at which real GDP and employment stop declining.

When is biz cycle complete?

- A business cycle is complete when it has gone through all four phases. Think of it as going from trough to trough.

Other indicators: unemployment rate

- The percentage of the labor force that is jobless and actively looking for work.

Other indicators: Consumer Price Index (CPI)

- A measure of changes in the prices of goods and services that consumers commonly purchase

  (inflation means prices are going up; deflation means prices are going down)

Other indicators: consumer confidence

- The degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending.

Other indicators: capacity utilization

- The extent to which the nation actually uses its installed productive capacity. Thus, it refers to the relationship between actual output that “is” actually produced with the installed equipment, and the potential output which “could” be produced with it, if capacity was fully used.

Other indicators: factory orders

- A monthly report that includes data on durable goods orders, non-durable goods, and factory inventories.

Other indicators: durable goods

- A good that does not quickly wear out. Items like bricks could be considered perfectly durable goods, because they should theoretically never wear out. Highly durable goods such as refrigerators, cars, or mobile phones usually continue to be useful for three or more years of use.

Other indicators: index of leading economic indicators

- An index published monthly used to predict the direction of the economy's movements in the months to come.