

The left side of the slide features a decorative design consisting of several vertical stripes of varying shades of light blue and grey. Overlaid on these stripes are several circles of different sizes and shades of teal and blue, arranged in a vertical, somewhat scattered pattern.

**MACROECONOMICS**

# **INTRODUCTION TO MACROECONOMICS**

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# INTRO

- individual decision-making ***Microeconomics examines the behavior*** of units—business firms and households.
- ***Macroeconomics deals with the economy*** as a whole; it examines the behavior of economic aggregates such as aggregate income, consumption, investment, and the overall level of prices.
  - ***Aggregate behavior refers to the behavior of*** all households and firms together.



# INTRO

- When we study the consumption behaviour or equilibrium of a consumer; the production pattern & equilibrium of a firm, the entire analysis is 'micro' in nature.....because

we study a UNIT and not the SYSTEM in which it is operating



# INTRO

- Microeconomists generally conclude that markets work well.
- Macroeconomists, however, observe that some important prices often seem “sticky”
- ▣ ***Sticky prices are prices that do not*** always adjust rapidly to maintain the equality between quantity supplied and quantity demanded.



# INTRO

- Macroeconomists often reflect on the microeconomic principles underlying macroeconomic analysis, or the *microeconomic foundations of macroeconomics*



# THE ROOTS OF MACROECONOMICS

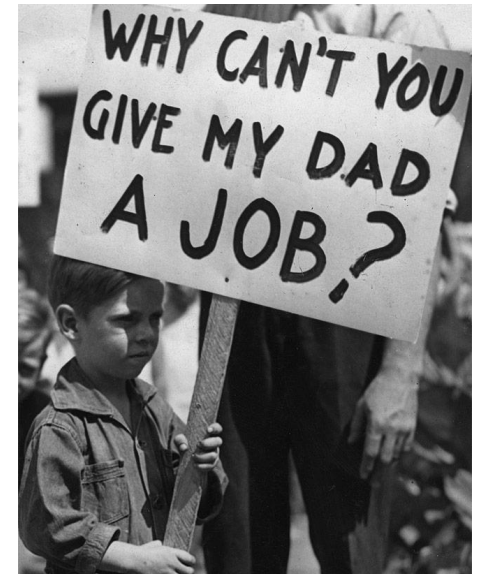
- The *Great Depression* was a period of severe economic contraction and high unemployment that began in 1929 and continued throughout the 1930s.

- Stock Markets crashed!
- 9000 banks filed for bankruptcy
- Banks that survived stopped giving loans.
- People cut down spending
- Large amounts of inventories started piling up
  
- Businesses stopped production....layoffs!( 25% unemployment)
- Purchasing power declined
- Hawley – Smoot tariff imposed on imports in 1930
- Decline in world trade & economic retaliation.



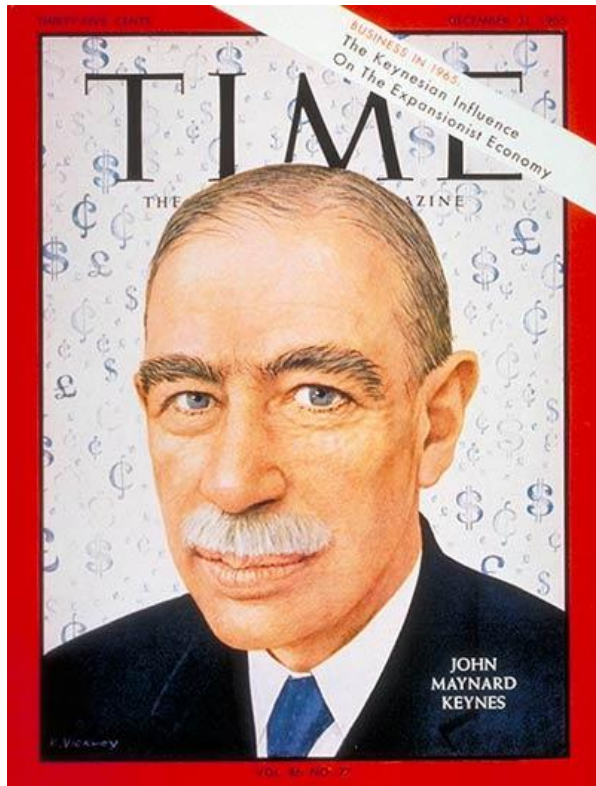
# THE ROOTS OF MACROECONOMICS

- Classical economists applied microeconomic models, or “market clearing” models, to economy-wide problems.
- However, simple classical models failed to explain the prolonged existence of high unemployment during the Great Depression. This provided the impetus for the development of macroeconomics



# THE ROOTS OF MACROECONOMICS

- In 1936, John Maynard Keynes published *The General Theory of Employment, Interest, and Money*.

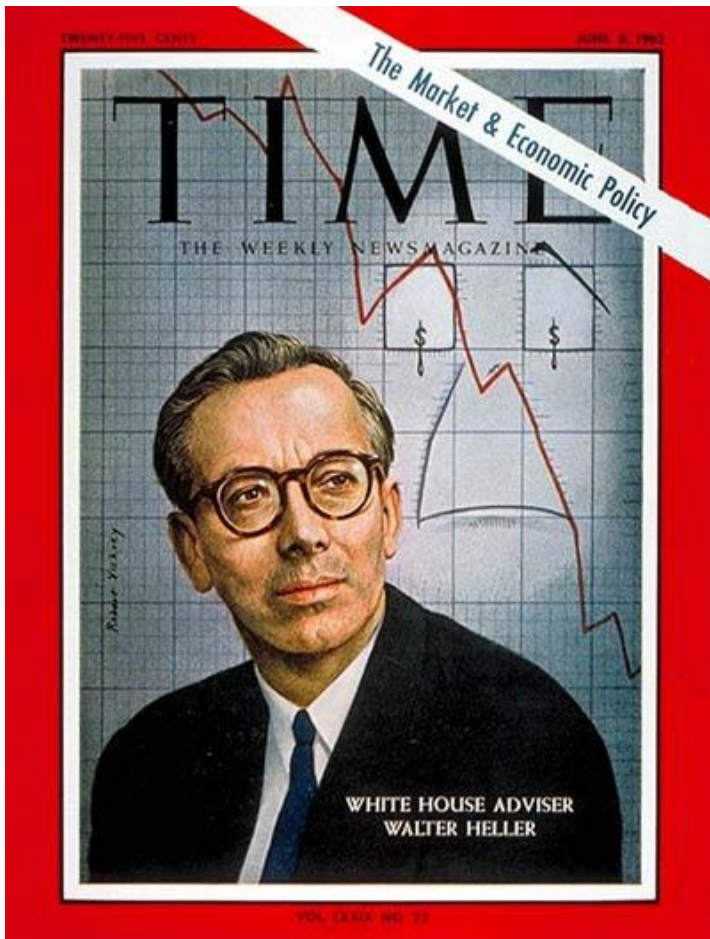


- Keynes believed governments could intervene in the economy and affect the level of output and employment.
- During periods of low private demand, the government can stimulate aggregate demand to lift the economy out of recession.





# RECENT MACROECONOMIC HISTORY



- *Fine-tuning* was the phrase used by Walter Heller to refer to the government's role in regulating inflation and unemployment.
- The use of Keynesian policy to fine-tune the economy in the 1960s, led to disillusionment in the 1970s and early 1980s.



# WHY TO STUDY MACROECONOMICS?

- Macroeconomics is the study of the nation's economy as a whole.
- We can use macroeconomic analysis to:
  - Understand why economies grow.
  - Understand economic fluctuations.
  - Make informed business decisions.



# MACROECONOMIC CONCERNS

- Three of the major concerns of macroeconomics are:
  - Inflation
  - Output growth
  - Unemployment



# INFLATION AND DEFLATION

- ▣ *Inflation is an increase in the overall price level.*
- ▣ *Hyperinflation is a period of very rapid increases in the overall price level.*

Hyperinflations are rare, but have been used to study the costs and consequences of even moderate inflation.

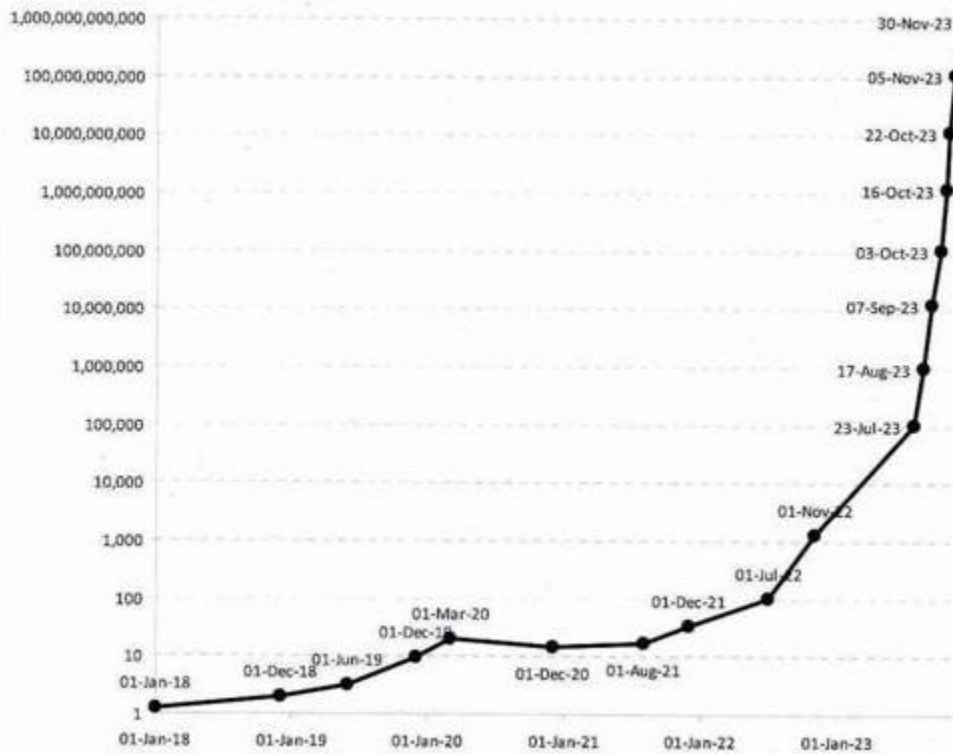
- ▣ *Deflation is a decrease in the overall price level. Prolonged periods of deflation can be just as damaging for the economy as sustained inflation.*



# INFLATION



1 "Gold"Mark = "Reichs"Mark 1918-1924



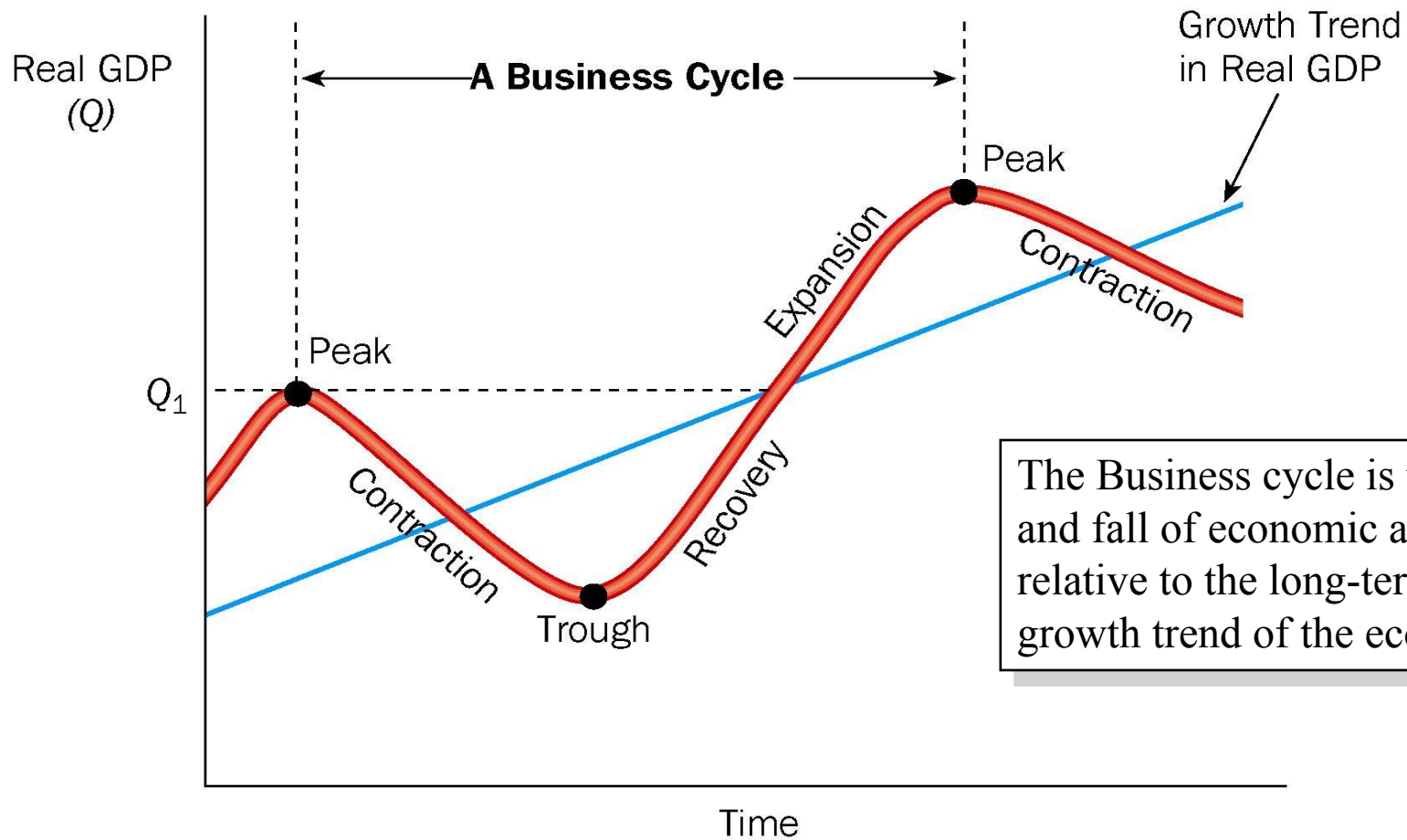
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# OUTPUT GROWTH: SHORT RUN AND LONG RUN

- The *business cycle is the cycle of* short-term ups and downs in the economy.
- The main measure of how an economy is doing is aggregate output:
  - *Aggregate output is the total quantity* of goods and services produced in an economy in a given period



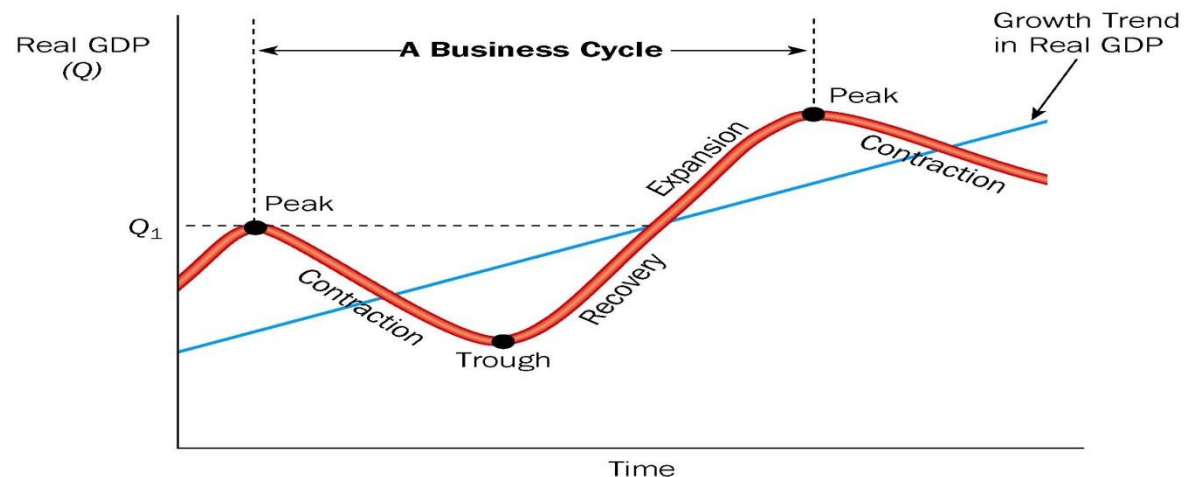


The Business cycle is the rise and fall of economic activity relative to the long-term growth trend of the economy



# UPS AND DOWNS OF THE BUSINESS CYCLE

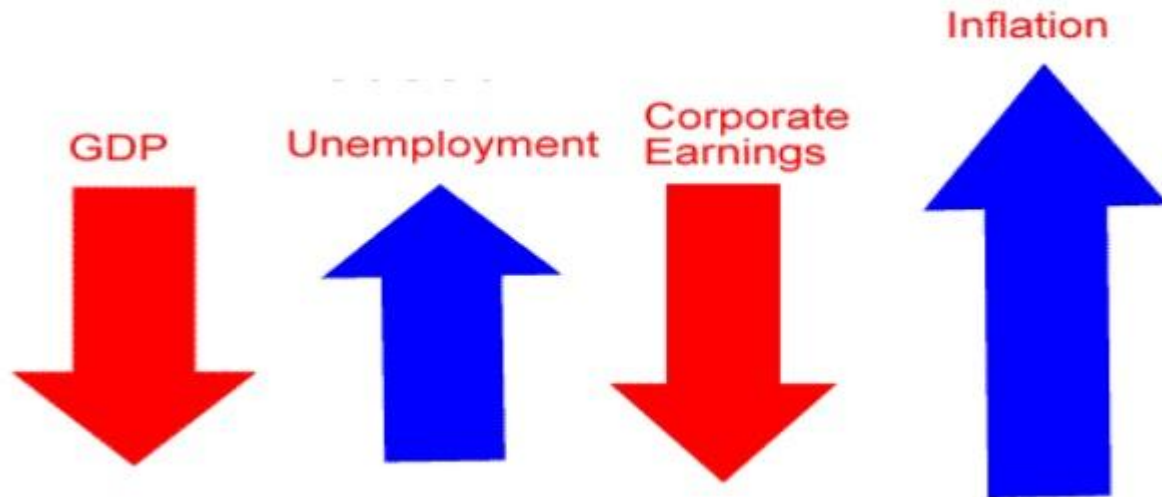
- ❑ Peak: at the peak of the business cycle, Real GDP is at a temporary high.
- ❑ Contraction: A decline in the real GDP. If it falls for two consecutive quarters, it is said the economy to be in a recession.
- ❑ Trough: The Low Point of the GDP, just before it begins to turn up.
- ❑ Recovery: When the GDP is rising from the trough.
- ❑ Expansion: when the real GDP expands beyond the recovery
- ❑ Recession : two consecutive quarter declines in Real DP





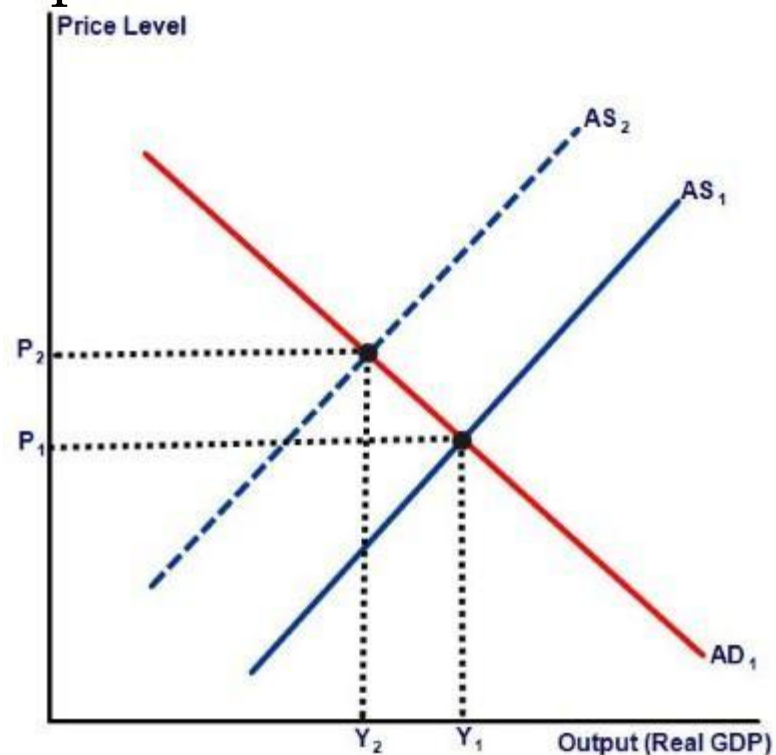
# RECENT MACROECONOMIC HISTORY

- ▣ *Stagflation occurs when the overall price level rises rapidly (inflation) during periods of recession or high and persistent unemployment (stagnation).*



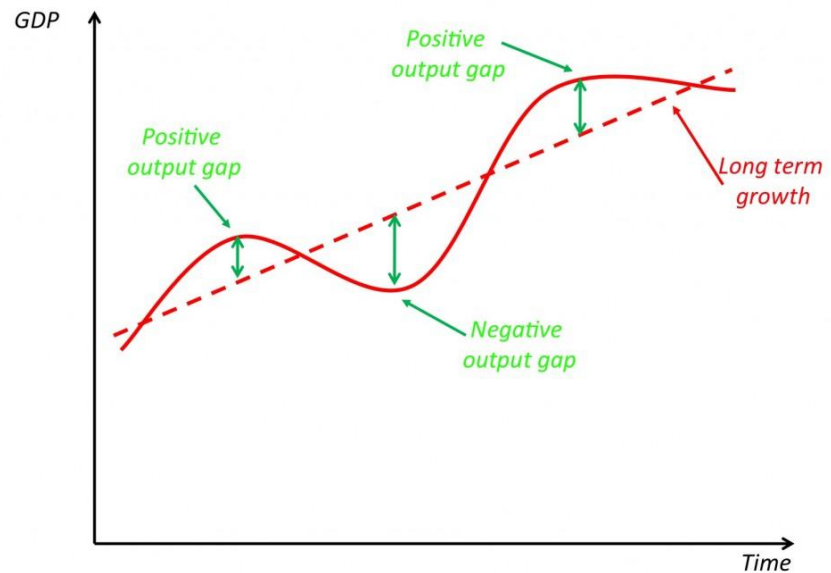
# STAGFLATION

- Stagflation is a contraction of a nation's output accompanied by inflation
- Stagflation is generally a “supply-side” phenomenon
- A dramatic increase in oil prices caused the stagflation of the 1970s



# OUTPUT GROWTH: SHORT RUN AND LONG RUN

- A *recession* is a *period during which* aggregate output declines. Two consecutive quarters of decrease in output signal a recession.

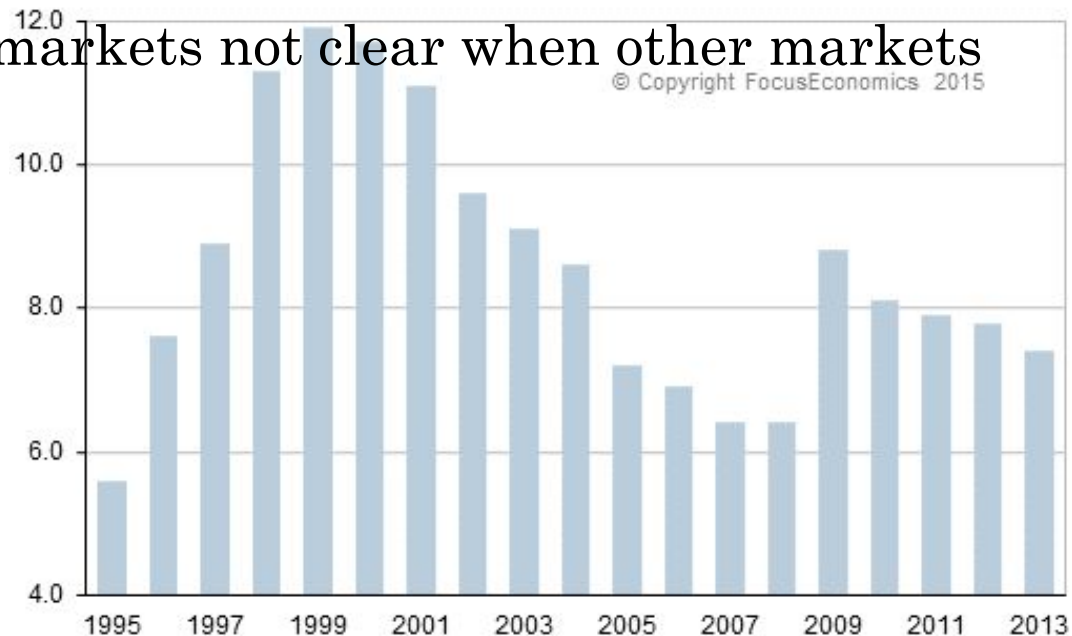


- A prolonged and deep recession becomes a *depression*
- Policy makers attempt not only to smooth fluctuations in output during a business cycle but also to increase the growth rate of output in the long-run.

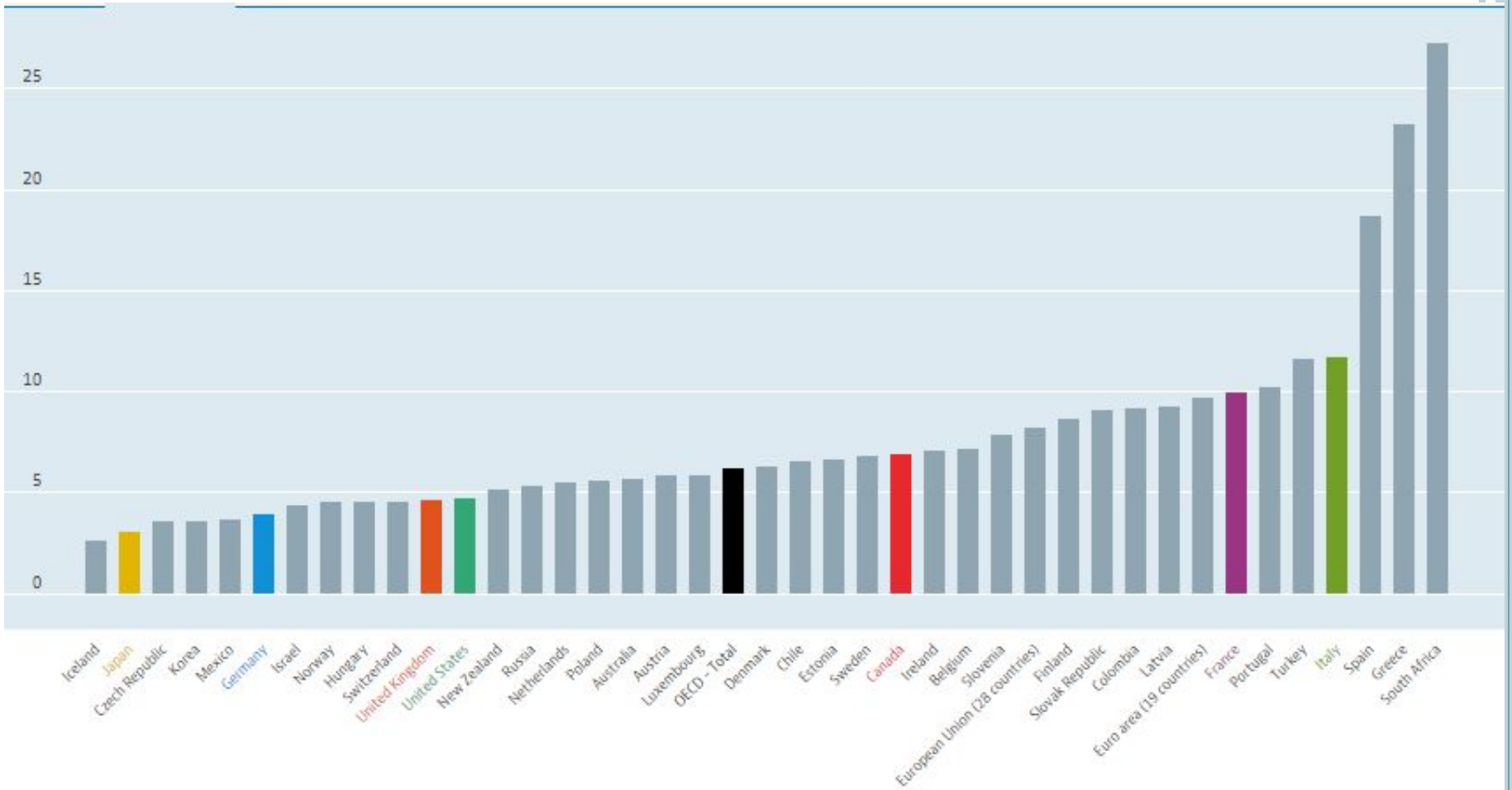


# UNEMPLOYMENT

- The *unemployment rate is the* percentage of the labor force that is unemployed.
  - The unemployment rate is a key indicator of the economy's health.
  - The existence of unemployment seems to imply that the aggregate labor market is not in equilibrium.
  - Why do labor markets not clear when other markets do?



# UNEMPLOYMENT



# GOVERNMENT IN THE MACROECONOMY

- There are three kinds of policy that the government has used to influence the macroeconomics:
  - Fiscal policy
  - Monetary policy
  - Growth or supply-side policies



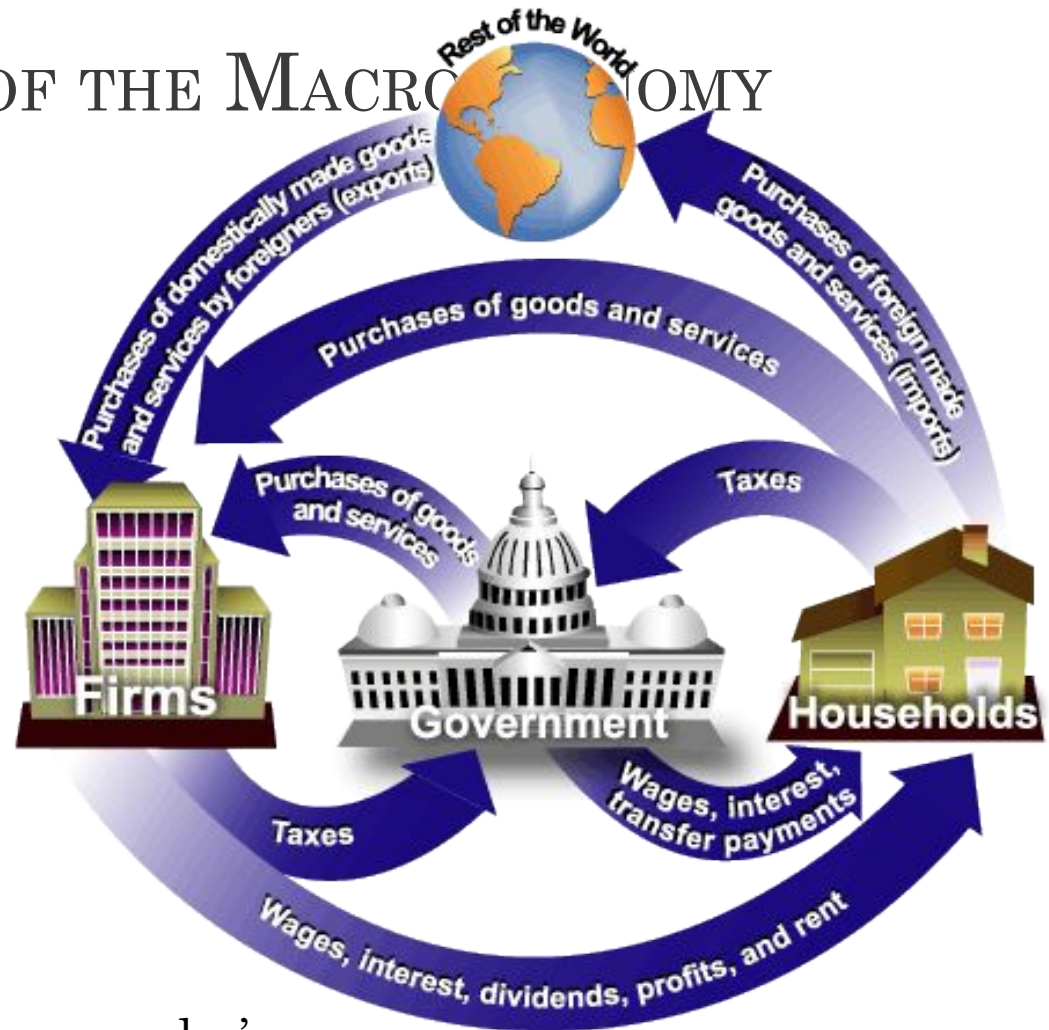
# GOVERNMENT IN THE MACROECONOMY

- ▣ ***Fiscal policy refers to government policies*** concerning taxes and spending.
- ▣ ***Monetary policy consists of tools used by*** the Federal Reserve to control the quantity of money in the economy.
- ▣ ***Growth policies are government policies*** that focus on stimulating aggregate supply instead of aggregate demand.



# THE COMPONENTS OF THE MACROECONOMY

- The *circular flow diagram* shows the income received and payments made by each sector of the economy.



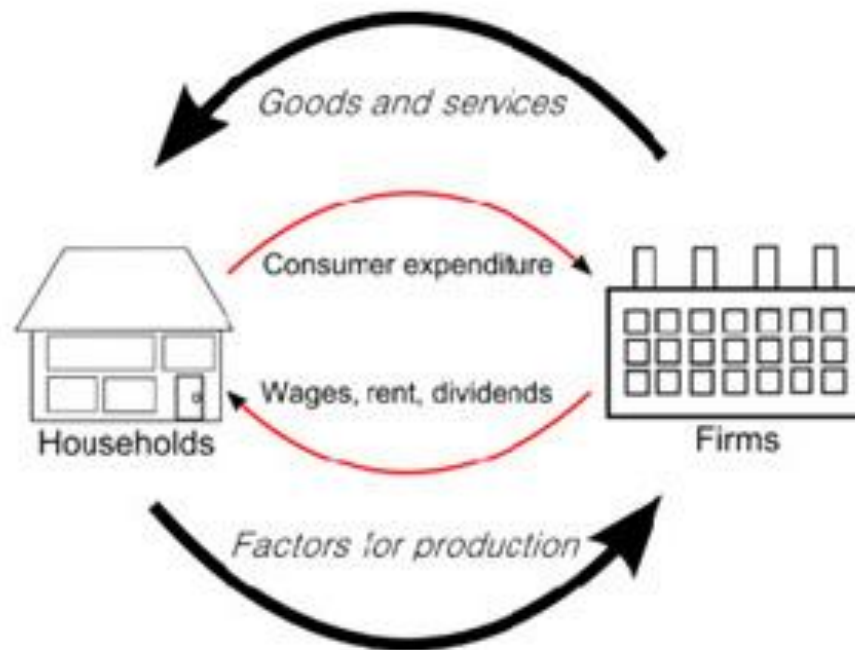
Everyone's expenditure is someone else's receipt. Every transaction must have two sides.



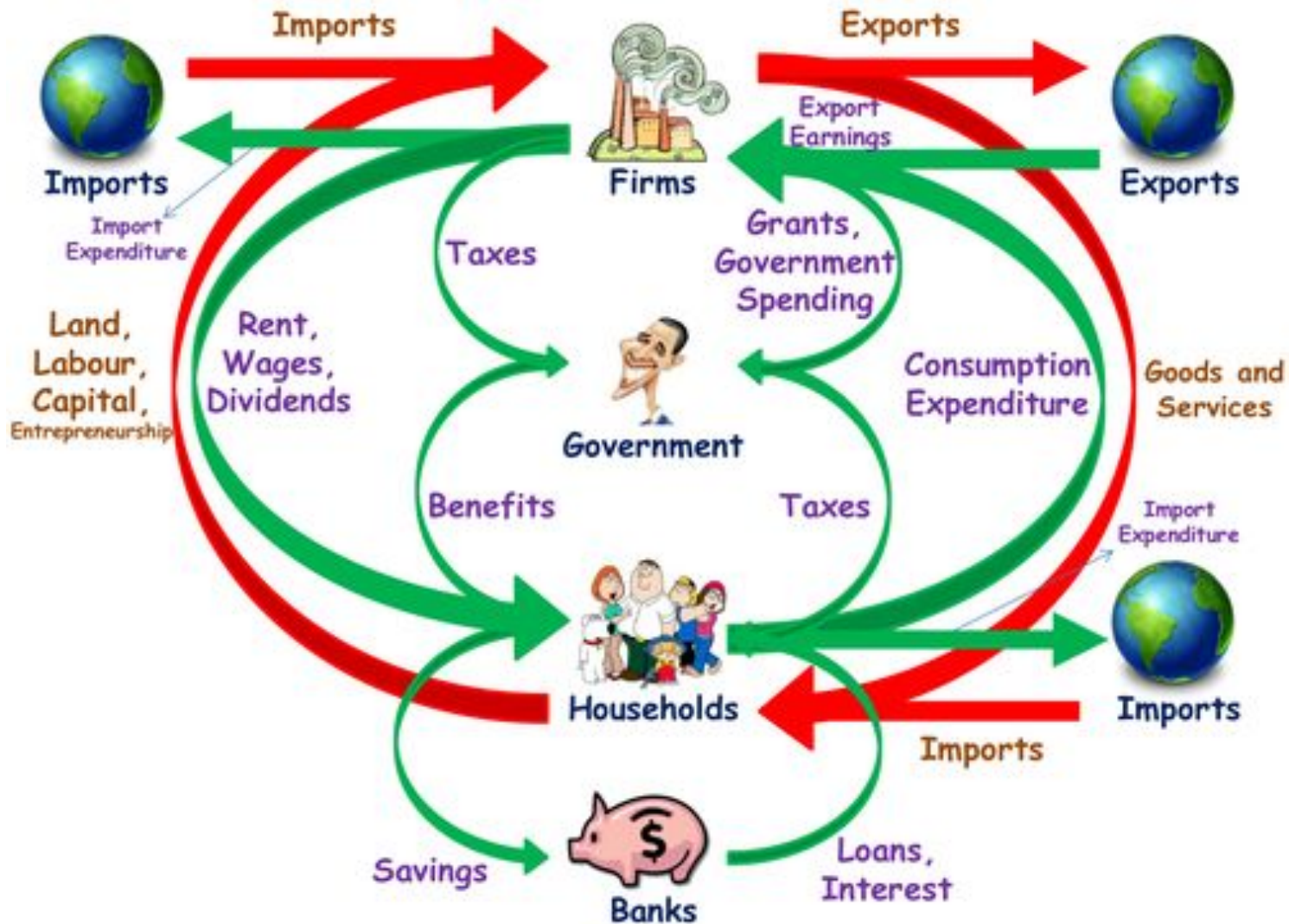


# THE COMPONENTS OF THE MACROECONOMY

## The circular flow of money and goods



# THE COMPONENTS OF THE MACROECONOMY



# THE COMPONENTS OF THE MACROECONOMY

- ▣ *Transfer payments are payments* made by the government to people who do not supply goods, services, or labor in exchange for these payments.



# THE THREE MARKET ARENAS

- Households, firms, the government, and the rest of the world all interact in three different market arenas:
  - Goods-and-services market
  - Labor market
  - Money (financial) market



# THE THREE MARKET ARENAS

- Households and the government purchase goods and services (*demand*) from firms in the ***goods-and services market, and*** firms supply to the goods and services market.
- In the ***labor market, firms and government*** purchase (demand) labor from households (supply).
  - The total supply of labor in the economy depends on the sum of decisions made by households.



# THE THREE MARKET ARENAS

- In the *money market – sometimes called the financial market* – households purchase stocks and bonds from firms.
  - Households *supply funds to this market in the expectation of earning income, and also demand (borrow) funds from this market.*
  - Firms, government, and the rest of the world also engage in borrowing and lending, coordinated by financial institutions.



# FINANCIAL INSTRUMENTS

- ▣ ***Treasury bonds, notes, and bills*** are promissory notes issued by the federal government when it borrows money.
- ▣ ***Corporate bonds are promissory*** notes issued by corporations when they borrow money
- ▣ ***Shares of stock are financial*** instruments that give to the holder a share in the firm's ownership and therefore the right to share in the firm's profits.
  - ***Dividends are the portion of a*** corporation's profits that the firm pays out each period to its shareholders when they borrow money.



# THE METHODOLOGY OF MACROECONOMICS

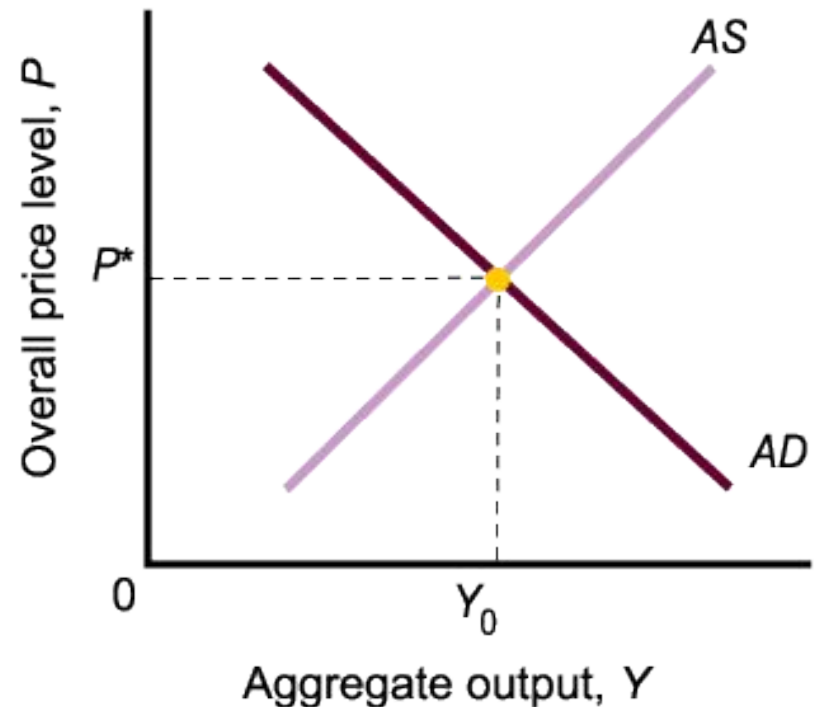
- Connections to microeconomics:
  - Macroeconomic behavior is the sum of all the microeconomic decisions made by individual households and firms. We cannot understand the former without some knowledge of the factors that influence the latter.





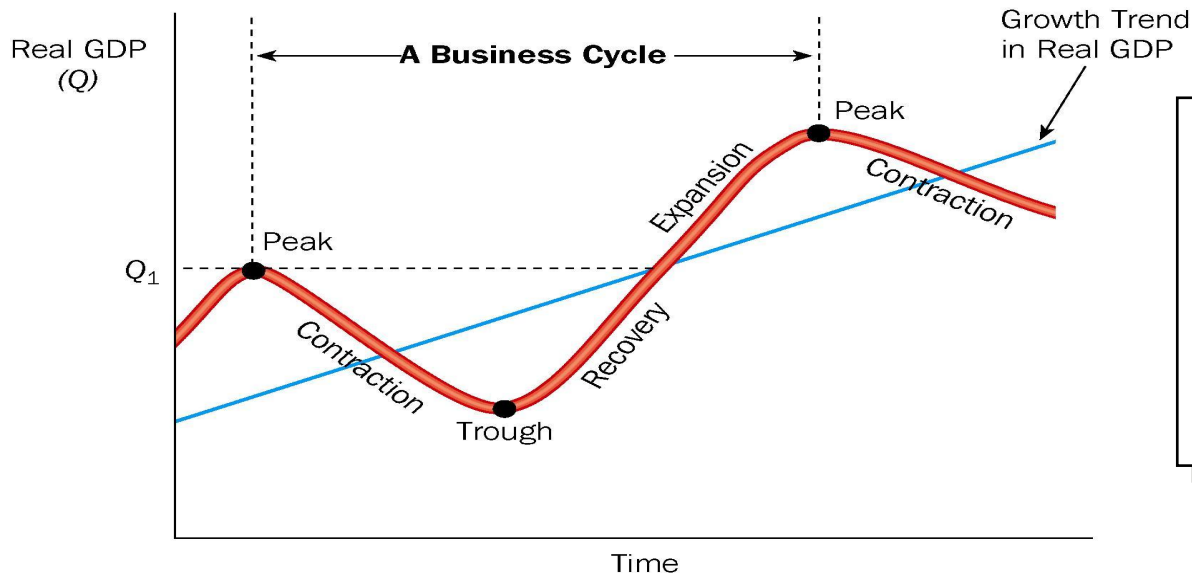
# AGGREGATE SUPPLY AND AGGREGATE DEMAND

- ▣ *Aggregate demand is the total demand for goods and services in an economy.*
- ▣ *Aggregate supply is the total supply of goods and services in an economy.*
  - Aggregate supply and demand curves are more complex than simple market supply and demand curves.



# EXPANSION AND CONTRACTION: THE BUSINESS CYCLE

- An ***expansion, or boom, is*** the period in the business cycle from a trough up to a peak, during which output and employment rise.
- A ***contraction, recession, or slump*** is the period in the business cycle from a peak down to a trough, during which output and employment fall.



The Business cycle is the rise and fall of economic activity relative to the long-term growth trend of the economy

# REVIEW TERMS AND CONCEPTS

- aggregate behavior
- aggregate demand
- aggregate output
- aggregate supply
- business cycle
- circular flow
- contraction, recession, or slump
- corporate bonds
- deflation
- depression
- microeconomics
- monetary policy
- recession
- shares of stock

