

Introduction to Macroeconomics

Econ 202 Lecture 1.1.

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Outline

- 1 Motivation
- 2 The roots of modern macro – where did Macro come from?
- 3 Main macroeconomics concepts
- 4 The role of the Government in the macroeconomy
- 5 The main participants in the macroeconomy
- 6 The main markets in the macroeconomy
- 7 Administration of the course

Motivation

The best time to start studying macroeconomics



The world is crazy.

by *The Economist*

Motivation

The best time to start studying macroeconomics

What happened on the global markets in the last quarter?

- Governments designing “*rescue plans*” for their economies
- Major economies going into *recessions* simultaneously
- Central banks desperately throw *liquidity* on the markets
- *Stock market indices* falling sharply around the world

Motivation

The content of the course

- Why are these things happening?
- What is their impact on incomes, investment, savings of the local economy, on inflation and exchange rates?
- What can the central banks and the governments do in situations like this?
- How are the effects from one market transferring to another?
- How are economies working? (And why are they failing?)
- What are the functions of money? And how can we make more of them?

What is Macroeconomics?

What are Microeconomics and Macroeconomics?

Microeconomics

Examines the functioning of individual industries and the behavior of individual decision-making units – business firms, consumers and households.

Macroeconomics

Deals with the economy as a whole. Macroeconomics focuses on the determinants of total national income, deals with aggregates such as aggregate consumption and investment, and looks at the overall level of prices instead of individual prices.

Aggregate behavior

The behavior of all households and firms together.

How did macro start?

The Great Depression

The period of severe economic contraction and high unemployment that began in 1929 and continued throughout the 1930s.

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1936: John Maynard Keynes published *The General Theory of Employment, Interest, and Money*. It is the aggregate demand for goods and services that determines the overall economic activity: the behavior of output, unemployment, and inflation.

The major concerns of macroeconomists (the temperature of the economy:-)

- 1 Inflation
- 2 Output growth
- 3 Unemployment

Inflation

An increase in the overall price level.

Hyperinflation

A period of very rapid increases in the overall price level.

Deflation

A decrease in the overall price level.

Output growth

Aggregate output

the total quantity of goods and services produced in an economy during a given time period. Aggregate output is the main measure of how an economy is doing.

Output growth

Percentage increase in the economy's production (GDP) level over the level achieved in the previous year.

Recessions

Periods (typically over 6 months) when aggregate output falls. A prolonged and deep recession is called a *depression*.

Business cycles

Increases and decreases in an economy's production (GDP).

Unemployment

Unemployment

A labor market event in which a person who has the right to work (is between 16 and 65 yrs. of age) actually does not work for various reasons

Unemployment rate

The *percentage* of the labor force that cannot find work.

Are people who do not look for a job part of the labor force?

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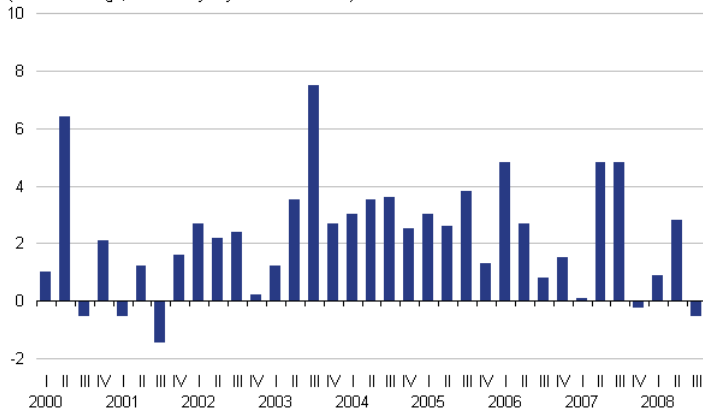
The labor force

The population between 16 and 65 yrs. of age that *can* and *are willing* to work.

Economic variables - an illustration







Real Gross Domestic Product

(Percent change, seasonally adjusted annual rate)



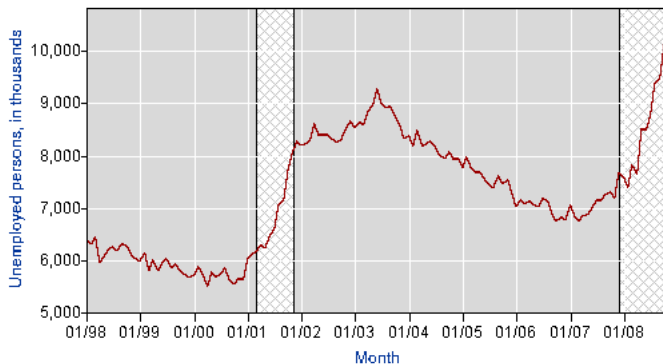
U.S. Bureau of Economic Analysis

Economic variables - an illustration

United States - Monthly Data							
Data Series	Back Data	May 2008	June 2008	July 2008	Aug 2008	Sept 2008	Oct 2008
Unemployment Rate (1)		5.5	5.5	5.7	6.1	6.1	6.5
Change in Payroll Employment (2)		-47	-100	-67	-127	(P) -284	(P) -240
Average Hourly Earnings (3)		17.95	18.00	18.06	18.14	(P) 18.17	(P) 18.21
Consumer Price Index (4)		0.6	1.1	0.8	-0.1	0.0	-1.0
Producer Price Index (5)		1.4	1.7	(P) 1.2	(P) -0.9	(P) -0.4	(P) -2.8
U.S. Import Price Index (6)		2.8	3.0	(R) 1.4	(R) -3.0	(R) -3.3	(R) -4.7

Economic variables - an illustration

Unemployed persons (seasonally adjusted)



Note: Cross-hatched area represents recession.

The role of the Government in the macroeconomy

To tackle the problems, G uses two main policies:

- ① **Fiscal Policy** is any change in the government's tax and expenditure decisions designed to influence the economy
 - When the economy is in a *recession* the government may use *expansionary fiscal policy*. This involves cutting taxes and/or raising government spending.
 - When the economy is experiencing *high growth and inflation*, the government may use *contractionary fiscal policy*. This means increasing taxes and/or cutting government spending.
- ② **Monetary Policy** is the management of money in the economy by the central bank.
 - Like fiscal policy, monetary policy can be either expansionary or contractionary.
 - The central bank uses its own policy tools to conduct monetary policy.

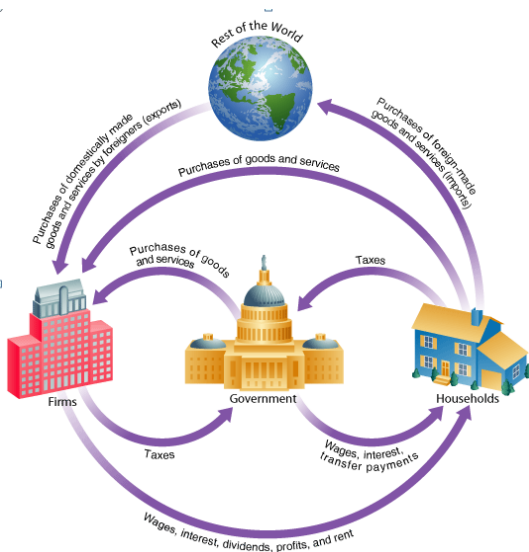
The main participants in the macroeconomy

- 1 Households
- 2 Firms. Households and firms together make up the *private sector*.
- 3 Government (the public sector)
- 4 The rest of the world (the international sector)

How do these participants interact?

The main participants in the macroeconomy

The circular flow diagram



The main markets in the macroeconomy

① Goods-and-Services Markets

- Households and the government purchase goods and services from firms
- Firms also purchase goods and services from each other
- The rest of the world both buys and sells goods and services

② Labor Market

- Firms and the government purchase labor services from households
- Households supply the labor

③ Money Market

- Households purchase common stock from firms and bonds from the government and firms
- The government borrows money from firms and households
- Firms borrow from the households and the government
- The rest of the world borrows to and lends from domestic agents

Administration of the course

This is how we do it...

How to get an excellent grade in Money and Banking?

- Attend the lectures – a point per lecture (10%)
- Study on a weekly basis
- Don't screw up the exams ;-)
 - Midterm is 20%
 - Final is 20%!
- Participate – a point for the two best participants in each class (10%)
- Do the homeworks – 20%
- Do not miss the quizzes – 20%