Macroeconomics

- THE BIG PICTURE
- Macroeconomics looks at the performance of our economy as a whole.
  - **Key Economic Indicators** measure the health of the national economy.

Questions – Section 13-1

- What is GDP (Gross Domestic Product)
- What things may be excluded from GDP? In each case, give a brief explanation of why.
- What are the four sectors measured in GDP? Explain each one briefly.
- What is the output-expenditure model?

Key Economic Indicators:

- Gross Domestic Product (GDP)
- Consumer Price Index
- Unemployment rate

Vital signs for the economy:

- Unemployment rate (blood pressure)
- Inflation rate (temperature)
- Real GDP growth rate (pulse rate)

Measuring Economic Activity

- Gross Domestic Product (GDP)
  - The total market value (dollar value) of all goods and services produced in a nation over a specific period of time – one year.

Gross Domestic Product (GDP)

- Equal the total of all consumer spending, business investment, government spending, and net exports.
- GDP = C + I + G + XN (remember, you may see this expressed as “XN”, “X-M”, or “F”)
- Where
  - C = consumer spending
  - I = investment
  - G = government spending
  - XN = exports - imports

- The reason we subtract our imports from our exports is this:
  - The money other countries spend on our exports adds value to our economy, while the money we spend on goods imported from other countries takes money out of our economy.

Assignment

- Go to page 341 of the text book. **List and describe** the things that are excluded from GDP.

- Describe the limitations of GDP.

Real GDP vs. Nominal GDP

- If the nation's GDP increases, the economy is growing (unless the increase was due to inflation or increase in prices)
- The **Real GDP** is an accurate measurement of how much the economy is growing.
- Must use a price index to adjust for inflation

Nominal GDP

- The GDP figure before adjusting for inflation
- A nation's rate of economic growth is the percentage change in its real GDP from one year to another

Inflation and the Consumer Price Index

- **Inflation** – an increase in the average price of goods and services bought by the average consumer.
- When prices go up, we get less for our money (spending more without buying more).
- Economists have to figure out how much of an increase in GDP is caused by rising prices
- AND How much is caused by a real increase in how much we produce and consume.

Deflation

- **Deflation** is a decrease in the average price of goods and services.
- When prices go down, we get more for our money, so that even if we are spending less, we might actually be buying more than we did before.

Consumer Price Index (CPI)

- A measurement of Inflation
- To calculate CPI:
- Add up the total price of a “market basket” of typical items bought by an average family in a month.
- They compare this total price to the total price of the same items during a base period, usually one year before.
- Then divide the current total cost by the previous total cost and multiply result by 100 to get a percentage.

CPI=

To calculate the consumer price index:

$$\frac{\text{Cost of today's market basket}}{\text{Cost of market basket in previous year}} \times 100$$

To Calculate the Inflation Rate

CPI of most recent year – CPI of previous year/CPI of year previous year X 100

Example:

- If CPI for 2011 was 179.9
- CPI for 2010 was 177.1
- *Then*
- *179.9 – 177.1 = 2.8*
- *2.8 / 177.1 = .016*
- *.016 x 100 = 1.6*

Consumer Price Index

- If the market basket costs $960 in the base year, 2006, and $1000 in the year 2007, the inflation rate for the period 2006-2007 would be calculated as follows:

- $CPI = \frac{1000}{960} \times 100 = 1.04 \times 100 = 104$

Inflation and CPI

- If we give the base year CPI a standard value, or index, of 100, then the increase from 100 to 104 represents a 4% increase in the CPI.
- If the GDP increased 4% in the same period, then we know that the increase was due only to inflation and that the real GDP, after adjusting for inflation, remained the same.
- If, on the other hand, the GDP increased 6%, with an inflation rate of 4%, then the real GDP rose 2%

Inflation

- Inflation occurs when the money supply in an economy increases too quickly.
- Governments often increase the money supply in order to encourage consumer spending and promote economic growth.

Inflation

- If prices increase but the economy does not grow, a situation called **stagflation** occurs.
- High inflation hurts wage earners, unless their employment contracts include a **cost-of-living adjustment**, which increases wages to keep up with inflation.

Unemployment

- Another key indicator of an economy's health is its unemployment rate.
- An economy with a low unemployment rate is usually healthy and growing, because it is not wasting its labor resources.
- More workers means more production and more consumption

Unemployment

- To calculate the unemployment rate, we do not count everyone who doesn't have a job.
- ONLY count those who are actively looking for jobs and are able to work.
- We don't count:
  - Children
  - Retired people
  - Students
  - Parents who choose to stay home rather than work outside the home
  - People who have given up looking for a job.

Unemployment

- To be counted in this calculation, you have to be in the **labor force.**
- Labor force – either you have a job or are looking for one.
- The formula for calculating unemployment is

$$\text{unemployment} = \frac{\text{number of people looking for work}}{\text{number of people in labor force}} \times 100$$

Unemployment

- Some, but not all, unemployment is the result of a downturn in the economy.
- Economists classify four different types of unemployment
  - Structural unemployment
  - Frictional unemployment
  - Seasonal unemployment
  - Cyclical unemployment

Structural Unemployment

- Occurs when the skills of the labor force do not match those that employers need.
- For example, factory workers are unemployed because the factories they used to work in have closed.
- New kinds of businesses have been started that require computer skills, which must either relocate to where their skills are needed, or learn new skills.

Frictional Unemployment

- Occurs when people decide not to take a particular job because they are looking for a better job that suits their talents, needs, and desires.
- For example, an unemployed office worker might be able to find a job in a grocery store, but would rather wait until they can find an office job that pays better and is more in line with their skills and experience.

Seasonal Unemployment

- Affects mainly people whose jobs depend on the weather.
- For example, snow plow drivers can find work only in the winter, while many construction workers are unemployed in the winter.

Cyclical Unemployment

- Occurs because of a downturn in the economy.
- Economies go through a cycle of good times and bad times.
- During the good times, companies hire workers and production goes up.
- If consumer demand goes down, however, companies cut production.
- Result: a lot of jobs lost
- When production starts increasing again, some of these workers may be rehired, but others may not.