Macroeconomic Questions...

• Will tomorrow’s world be more prosperous than today?

• Will jobs be plentiful?

• Will the cost of living be stable?

• Will the government and the nation go into deficit again?
Macro Concepts

- Economic Growth and Fluctuations
- Jobs and Unemployment
- Inflation
- Surpluses and Deficits
- Macroeconomic Policy Tools
Economic Growth

- **Economic growth** is the expansion of the economy’s production possibilities—an outward shifting PPF.

- We measure economic growth by the increase in real GDP.

- **Real GDP**—real gross domestic product—is the value of the total production of all the nation’s farms, factories, shops, and offices, measured in the prices of a single year.
Economic Growth and Fluctuations

- **US Economic Growth**

- **The figure highlights:**
  - Fluctuations of real GDP
  - Smoother growth of potential GDP

Source: Bureau of Economic Analysis
Economic Growth and Fluctuations

• Potential GDP
  – real GDP when all labor, capital, land, and entrepreneurial ability are fully employed.

• 70s and early 80s, real GDP growth slowed—a productivity growth slowdown.

Source: Bureau of Economic Analysis
Economic Growth and Fluctuations

- Real GDP fluctuates around potential GDP in a business cycle
  - Booms and busts.

The long term growth rate is ...
... 3.1 percent per year
... 2.8 percent per year
... 4.4 percent per year
... 2.9 percent per year
Economic Growth and Fluctuations

Every business cycle has two phases:
1. Recession
2. Expansion

and two turning points:
1. A peak
2. A trough

- A *recession* - real GDP decreases for at least two successive quarters.
- An *expansion* - real GDP increases.
Economic Growth and Fluctuations

- recent U.S. cycles.
Economic Growth and Fluctuations

- The long-term growth trend and cycles
Economic Growth and Fluctuations

- Economic Growth Around the World
  - growth rate of real GDP in the US & the world average growth rate.

(a) The United States and the rest of the world: 1980 - 2008

Source: IMF World Economic Outlook Database, October 2008
Economic Growth and Fluctuations

- Economic Growth Around the World
  - the growth rate of real GDP in the US relative to other countries and regions.
  - Asian economies have grown persistently faster than the rest of the world.
  - Industrialized countries are growing relatively slower than developing countries.

(b) Countries and Regions Compared: 1997 - 2007 average

- Source: IMF World Economic Outlook Database, October 2008
Economic Growth and Fluctuations

• The Lucas Wedge
  – The **Lucas wedge** is the accumulated loss of output from a slowdown in the growth rate of real GDP per person.
  – Figure 4(a) shows that the U.S. Lucas wedge is some $50 trillion or five year’s GDP.
Economic Growth and Fluctuations

• The Okun Gap
  – The **Okun gap** is the gap between potential GDP and real GDP – also called the output gap.
  – The Okun gaps since 1973 are $2.7 trillion or about 3 months real GDP.
Benefits and Costs of Economic Growth

• Benefit -- expanded consumption possibilities:
  – more health care for the poor and elderly,
  – more research on cancer and AIDS
  – more space exploration
  – better roads and infrastructure
  – more and better housing
  – cleaner environment.

• Costs –
  – forgone consumption in the present
  – more rapid depletion of nonrenewable natural resources
  – more frequent job changes.
Introduction to Key Macro Concepts

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Jobs and Unemployment

• Jobs (Job Creation)
  ➢ The U.S. economy created around 2 million jobs a year, on average during the 1990s.

  ➢ This number fluctuates a lot and since 2001 the pace of job creation has been slow. Since the beginning of 2000, the U.S. economy has created approximately 720 thousand jobs a year on average.
Unemployment

- **Unemployment** is a state in which a person does not have a job but is available for work, willing to work, and has made some effort to find work within the previous four weeks.
- The **labor force** is the total number of people who are employed and unemployed.
- The **unemployment rate** is the percentage of the people in the labor force who are unemployed.
- A **discouraged worker** is a person who available for work, willing to work, but who has given up the effort to find work.
Jobs and Unemployment

- Unemployment in the United States
  - Figure 5 shows the unemployment rate in the United States since 1926.
  - During the 1930s, the unemployment rate hit 25 percent.
  - The lowest rate occurred during World War II at 1.2 percent.
Jobs and Unemployment

- During recent recessions, the unemployment rate increases.
- The unemployment rate has averaged 6 percent since World War II.
Jobs and Unemployment

- In this latest 2008 recession, the unemployment rate (as of December 2008) was at 6.7 percent.

- The figure to the right shows how the unemployment rate has changed over the most recent cycle.

Source: Bureau of Labor Statistics
Jobs and Unemployment

• Unemployment Around the World
  ➢ Figure 6 compares the unemployment rate in the United States with those in Western Europe, Japan, Canada and the United Kingdom.
  ➢ In the 1960’s – 1970’s, U.S. unemployment, on the average, was higher than the other countries shown.
  ➢ More recently, US unemployment has declined relative to the other countries.

Source: IMF’s World Economic Outlook Database
Jobs and Unemployment

• Why Unemployment Is a Problem

• two main reasons:
  – Lost production and incomes
  – Lost human capital

• Temporary problem: The loss of a job brings an immediate loss of income and production

• Permanent problem: A prolonged spell of unemployment can bring damage through the loss of human capital
Key Macro Concepts

- Economic Growth and Fluctuations
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Inflation

- **Inflation** is a process of rising prices.

- The *inflation rate*: the percentage change in the *average* level of prices or the *price level*.

- The Consumer Price Index — the CPI — is a common measure of the price level used to calculate inflation.
Inflation

- Inflation in the US
  - Inflation rate in the US since 1961.
  - Inflation was low during the 1960s
  - Inflation increased during the 1970s
  - Inflation was lowered in two waves during the 1980s and 1990s
Inflation

- The inflation rate fluctuates, but it is always positive — the price level has not fallen during the years shown in the figure.

- A falling price level — a negative inflation rate — is called deflation.
Inflation

- Inflation Around the World
  - Figure 9 shows the inflation rate in the United States compared with other countries.
  - U.S. inflation has been similar to that in other industrial countries.

- U.S. inflation has been much lower than that in developing countries.

Note: These notes are incomplete without having attended lectures.
Inflation

Is Inflation a Problem?

- Unpredictable changes in the inflation rate are a problem because they redistribute income in arbitrary ways between employers and workers and between borrowers and lenders.

- A high inflation rate is a problem because it diverts resources from productive activities to inflation forecasting.

- Eradicating is costly because it brings a period of greater than average unemployment.
Introduction to Key Macro Concepts

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Surpluses and Deficits

Domestic/Government Budget Surplus and Deficit

- Taxes > spending, budget surplus.
- Spends > taxes, budget deficit.
Surpluses and Deficits

- Surplus and deficit of the federal and provincial governments in the US since 1971.
- Persistent federal deficit during the 1970s through 1990s.
- Surplus from 1998 to 2001
- More deficits following.
Surpluses and Deficits

International Surplus and Deficit

- Imports > exports: trade deficit.
- Exports > imports: trade surplus.

- The current account deficit or surplus is the balance of exports minus imports plus net interest paid to and received from the rest of the world.
Surpluses and Deficits

- The U.S. current account balance since 1960.

- Persistent current account deficit since 1983

- The deficit has swollen during the past few years

Source: Bureau of Economic Analysis
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Macroeconomic Policy
Challenges and Tools

Five policy challenges for macroeconomics:

1. Boost economic growth
2. Keep inflation low
3. Stabilize the business cycle
4. Reduce unemployment
5. Reduce government and international deficits