Introduction to Macroeconomics

• Macroeconomics versus Microeconomics?
  – Micro: Greek for small
    • Microeconomics: the study of the parts of the economy.
  – Macro: Greek for large
    • Macroeconomics: the study of the whole economy

Introduction to Macroeconomics

• Economic Theory
  – A process of simplification
  – Focuses on a few key relationships

Introduction to Macroeconomics

• Macroeconomics deals with issues like:
  – The unemployment rate
  – The inflation rate
  – Productivity growth
  – Interest rates
  – The government budget deficit
  – The foreign trade deficit

Introduction to Macroeconomics

• Real Gross Domestic Product (GDP)
  – The official measure of the economy’s total output.
  – Includes all currently produced goods and services sold on the market within a given time period.
  – Excludes certain types of economic activity
  – Real means the measure is adjusted for inflation

Introduction to Macroeconomics

• Real GDP (continued)
  – Business Cycles
    • Components (Figure 1-1)
      – Peak
      – Recession
      – Trough
      – Recovery and expansion
    • Features
      – pervasive nature
      – recurrent but not periodic
      – expansions longer than recessions
      – differ in length
Introduction to Macroeconomics

• Real GDP (continued)
  – Stabilization Policy (continued)
    • Framework
      – Target variables
      – Policy instruments
        » Monetary policy
        » Fiscal policy
        » Miscellaneous policies
      † Regulatory policies
      † Wage and Price policies
      † Employment policies

• Problems
  – Lags
  – Impact uncertainty
Introduction to Macroeconomics

- Real GDP (continued)
  - Stabilization Policy (continued)
    - Theory versus Policy
      - Positive Economics: explains the behavior of the economy
      - Normative Economics: recommends changes in economic policy
        - major focus of disagreement among economists

- The "internationalization" of macroeconomics
  - Closed economy
  - Open economy
    - Changes in positive economics
    - Changes in effectiveness of policy instruments
    - Changes in normative economics

Introduction to Macroeconomics

- The Nature of Business Cycles
  - Business Cycles and Inflation
    - Natural real GDP
      - Level of real GDP at which the inflation rate is constant
        - Figure 1-2

Introduction to Macroeconomics

- The Nature of Business Cycles (continued)
  - Business Cycles and Unemployment
    - Natural Rate of Unemployment
      - Level of unemployment at which the inflation rate is constant
        - Figure 1-3
      - neither optimal nor immutable

Figure 1-2
The Relation Between Actual and Natural Real GDP and the Inflation Rate

Figure 1-3
The Behavior over Time of Actual and Natural Real GDP and the Actual and Natural Rates of Unemployment
Introduction to Macroeconomics

- The Nature of Business Cycles (continued)
  - Relationship between real GDP, Inflation, & Unemployment
  - Is there a natural rate of inflation?
  - Highlights the importance of trade-offs

Introduction to Macroeconomics

- Six Macroeconomic Puzzles
  - Why has the unemployment rate been so high and so variable? (Figure 1-7)
  - Why has the inflation rate (at times) been so high and so variable? (Figure 1-8)
  - Why has productivity grown so slowly? (Figure 1-9)
  - Why have real interest rates been so high? (Figure 1-10)
  - Why has the government budget deficit persisted? (Figure 1-11)
  - Why has the US’s international trade dropped in persistent deficit? (Figure 1-12)