

Lecture 4 – The Economic Environment

Output and Growth

Components of **output** (how much stuff is produced in a **national** economy in a time period)

- Consumption
- Investment: expenditure by businesses
- Government spending: on infrastructure
- Net Exports: (exports – imports)

AD (Aggregate demand): total spending on goods & services [AD = C + I + G + Nx]

Investment, Interest Rates and Monetary Policy & Fiscal Policy

- **Monetary expansion:** money supply increases by purchasing bonds
 - central bank (RBA) lowers interest rate and low interest rate boosts economic activity, encourages spending and investment rather than saving
- **Monetary contraction:** increase interest rate, high interest rate slows economic activity, encourages saving rather than consumption

Low interest rates – support the boom in housing market which leads to a pickup of residential construction and rise in retail sales, overall business is rising, inflation picks up (a sign of rising demand), boosting economic growth, increased in exports

- **Government discretionary spending**
 - **fiscal expansion** (if economy is slowing down), gov. increases spending to boost GDP, but requires increase in taxes or borrowing e.g. Rudd's stimulus package
 - **fiscal consolidation**, government cuts back on spending programs, if perceived to be permanent then can lead to increase in private consumption

Trade and trade barriers

Free trade: efficient as competitive firms **gain access to bigger markets** but inefficient as firms are exposed to greater **competition**

Not so equal and not so free ... **tariffs** (tax on imports), **subsidies** (Gov. Payment to domestic businesses)

Threats to free trade: recession, beggar-thy-neighbour policies, tit-for-tat protectionism

Measuring output -> real GDP accounts for changes in **price level**, per capita GDP accounts for changes in the **population**

Prices and Inflation

Demand pull inflation – increased in demand beyond available supply, increasing competition for available goods pushes up prices