The Global Economy

What is **economics?**

-Study of production, distribution and consumption of anything that involves human actions.
-Social science

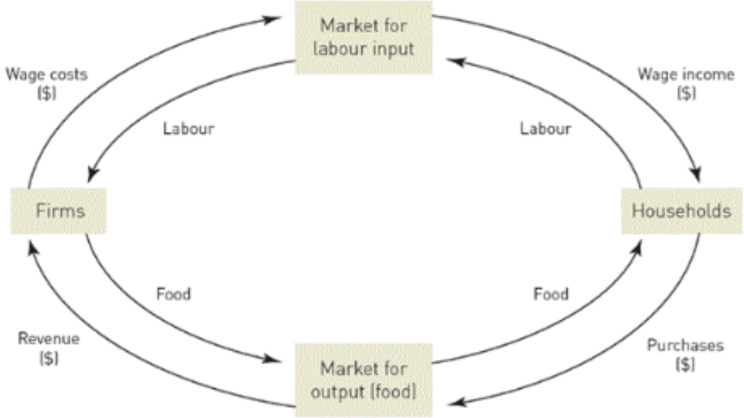
What is **macroeconomics?**

-Macroeconomics is the study of aggregates or whole systems (the economy)
- A central concern of macroeconomics is how the economy as a whole grows and changes over time

Macroeconomics **aggregates:**
- Gross domestic product (GDP): total output of goods and services produced in a country over a given period of time, normally a year
-General price level: measure of the average price of all the goods and services in an economy

The circular flow diagram: a model of macroeconomy

Flow of funds through economy:



A TWO-SECTOR CIRCULAR FLOW MODEL

-This two-sector circular model shows how firms and households interact in markets and how funds flow through the economy
-Owners of factors of production (households) supply and sell inputs to firms and earn income (wage, profit and rent)

Macroeconomics vs microeconomics

Microeconomics: the branch of economics that examines individual decision making by firms and households, and the way in which they interact in specific industries and markets

Macroeconomics: the branch of economics that examines the workings and problems of the economy as a whole

The **macroeconomy** behaves differently than if each individual component were considered by itself

Economic Models

Economic models are explanations of how the economy or part of the economy works

Macroeconomic models

-Economic models and theories are used to describe and explain economic facts and observations
-A macroeconomic model is an explanation of how the economy or a large part of the economy works
-Macroeconomic models are abstractions, or simplifications, of the real world that can be described with words, numerical tables, graphs and algebra

Positive vs normative statements

-Positive economics is about what is observed as 'facts', open to testing, verifiable or can be proved or disproved

-Normative economics is about values, emotions, beliefs, involves 'value judgements'

Positive e.g. ' a reduction in taxation rates will lead to an increase in spending by individuals'

Normative e.g. 'individuals **should** receive reductions in taxation as they are able to decide how to spend money to maximize their satisfaction better than the government'

Gross domestic product (GDP)

-**The market value of final goods and services produced in a country during a given period**
-GDP is the most common measure of total output
-The total value of output is the sum of the price of each good or service times the quantity of each produced over a year
-A flow concept over time versus a stock concept, the store of resources

GDP is one of the most keenly monitored of all macroeconomic indicators:

Looking at this year's GDP compared with last year's helps indicate how well an economy is doing

GDP reflects the rate of unemployment, and the ability of households to purchase goods and services

Countries with a high level of GDP per person (GDP/population) also tend to be rich countries, with high standards of living, (although it depends on the distribution of income)

Real gross domestic product (real GDP) is a measure of the value of all goods and services newly produced in the economy during a specified period of time, adjusted for inflation.

Measuring GDP

Example:
In the economy of country A, production consists of 10 CDs and 20 bus trips. If each CD has a price of $25 and a bus trip is $10, how much is the GDP of country A?
GDP = (10 × $25) + (20 × $10) = 250 + 200 = $450

-Value added is the value of a firm's production minus the value of intermediate goods
-An **intermediate good** is a good that undergoes further processing before it is sold

The spending approach to measuring GDP

Total spending is divided into four categories:
-Consumption
-Investment
-Government expenditure
-Net exports (exports minus imports)

Consumption (C):
The first category, consumption (C), includes purchases of final goods and services by individuals or households.

Investment (I)
Consists of purchases of final goods by firms as well as construction (including housing) and inventory investment. Investment takes the form of newly produced capital goods
Note: spending by governments on capital goods is not included in this grouping; it is included under government spending

Business fixed investment: investment by businesses in physical capital, such as factories and equipment (note that this is not the same as financial investment which only involves speculation with money)

Inventory investment: a change in the inventory from one date to another

Disinvestment: negative investment

Residential investment: purchases of new houses and apartments