ECON1002

Introductory Macroeconomics

WEEK 1: INTRODUCTION TO MACROECONOMICS

1.1 INTRODUCTION

- ***Macroeconomics*** is the set of theories about how the economy as a whole works. 3 broad themes:
  - Judgements of performance of economy
  - Understanding factors that result in certain macroeconomic outcomes
  - Role of governments in influencing economic performance
- It studies the **aggregate impact of individual decisions**
  - Aggregate supply & demand
  - National output, employment and price level
  - Examines a country economic relationship with the rest of the world
- Microeconomics provides a foundation for macroeconomics and macroeconomics underpins many microeconomic decisions

1.2 PERFORMANCE OF A NATIONAL ECONOMY

- Economic growth correlates to a rising standard of living (due to increases in production of goods and services)
- Macroeconomic theories forecast future levels of economic variables (growth, employment, prices, production…) and help understand and estimate the impact of economic policies and events
- Indicators of a well-performing economy
  - *Living standards increasing in long run*
  - *Price level under control*
  - *Needs for saving and investing are balanced*
  - *All individuals are seeking work and employed*
  - *Short-run macroeconomic fluctuations are avoided*
  - *Debt is kept at manageable level*
  - *Resources and scarcity of resources*

1.3 MAJOR FORTHCOMING ISSUES

- Brexit, Europe, some future financial crisis,
- Global free trade,
- New technology,
- Population pressures, migration

Environmental challenges
Rise of new world powers
Inequalities

1.4 MAJOR MACROECONOMIC ISSUES

1.4.1 ECONOMIC GROWTH AND LIVING STANDARDS

- High standards of living are the result of centuries of sustained economic growth, or the steady increase in the quantity and quality of goods and services produced
- Global standards of living are improving, mainly due to growth in 'tiger' economies like China and India
- >50% of world population lives on less than US$4000 per year (little economic growth over the past 100 years in these nations)

- The fact that not all countries have shared this growth shows that these outcomes are not inevitable
- Growth rate $((1+r)^n - 1 = \% \quad e.g \quad 1.01^{40} - 1 = 48\%)$ - study growth rate

1.4.2 LABOUR PRODUCTIVITY

- Average labour productivity is closely related to standard of living & grown rapidly
- Rate of improvements in labour productivity has slowed since 1997
  - Explanations: The present information and communication technology is not transforming the economy to the same extent that earlier general-purpose technologies did.
  - Much of the benefits from the digital revolution are unrecognised by a system of national accounts designed to measure industrial economy
  - Secular stagnation - since the key to productivity is investment which is spurred by expectations of economic growth, the incentive to invest is diminishing due to slower population growth

1.4.3 RECESSIONS AND EXPANSIONS

- Economies experience periods of particular weakness (recession) or strength (expansions or boom)
- ***Expansion:*** output is expanding, high employments rates, opposite is ***Contraction***
- Recession is two consecutive quarters of aggregate output falls

1.4.4 UNEMPLOYMENT

- Increases during recessions and decreases in booms
- Employment is a concern when it is systemic, affecting the entire economy

1.4.5 INFLATION

- Inflation is the rate at which prices are increasing over time (deflation sustained fall)
- Changes in price levels command different real purchasing power of currency

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1.5 GROSS DOMESTIC PRODUCT

- GDP is most used measure of economies performance over time or as comparison to other economies
- Proxy for living standards
- GDP measures the market value of all final goods and services produced during a year by an economy
- Exclude intermediate goods and services (those for resale)
- 3 ways to measure GDP:
  1. **PRODUCT APPROACH:** sum of the ***value added*** at each stage of the production process $GDP = Wages + Gross\ Profit = W + \Pi = W + TR - TC$
  2. **EXPENDITURE APPROACH:** Adding up all the aggregate expenditure on all final goods and services produced during the year $GDP = C + I + G + X - M$
  3. **INCOME MEASURE:** sums the incomes of all involved in the production process $GDP = W + \Pi + MI + IT - Sb \quad MI =$ Mixed income , $IT =$ Indirect taxes (revenues from value-added taxed (VAT), sales taxes (GST), customs duties etc) $Sb =$ subsidies

1.6 LIMITATIONS OF NATIONAL ACCOUNTING METHODS

- GDP underestimates the size of the economy - household production and non-market economic actives not included in GDP - the underground economy
- GDP measures also ignore leisure, life quality, economic equality/inequality - wealth distribution, depreciation, cost of externalities, ignores the impact of production on stocks (natural resources)

1.7 NOMINAL VS REAL GDP

- Nominal GDP - value of output at the prices prevailing in the period during which the output is produced - useful for comparisons across countries
- Real GDP - Output produced in any one period at the prices of some base year. The growth rate f the economy is the rate at which real GDP is increasing (more accurate) - adjusted for inflation
- Economic growth rate: $\frac{Real\ GDP_{2018}}{Real\ GDP_{2017}} \times 100 - 100$
- GDP per capita is the most important indicator of an economies native long-run performance
- Easterlin Paradox - rich people are happier than poorer people on average, however growing national income is not always accompanied by growing happiness. This suggests once basic needs are satisfies, higher income does not increase happiness