Chapter 1: Macroeconomics: The big picture (week 1)

Introduction

Macroeconomics is the study of the economy as a whole.

A central concern of macroeconomics is how the economy as a whole grows and changes over time.

Macroeconomics is essential to determining good policy and building economic systems that are prosperous, environmentally sustainable and resilient against disturbances.

Thinking like a macroeconomist

The discipline of macroeconomics:

Def^n: 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

Def^n: Macroeconomics: The branch of economics that examines the workings and problems of the economy as a whole

In general, macroeconomics is the study of aggregates or whole systems. It looks at how the big parts fit together. Macroeconomic aggregates include GDP and the general price level.

Def^n: GDP: A measure of the value of all goods and services newly produced in an economy during a specified period of time

Def^n: Price level (P): The average price of total output

It is important to recognise that macroeconomics is not a scaled up version of microeconomics.

Macroeconomists do it with models:

Def^n: Macroeconomic model: An explanation of how the macro economy or part of the macro economy works

Macroeconomic models use a ceteris paribus assumption, which means that our models hold "all other things equal."

Science, values and ethics

Positive vs normative economics:

Def^n: Positive economics: How the economy in fact works

Def^n: Normative economics: Debating our goals and preferred economic outcomes

Positive economics relates to the realm of facts- what is, what was, what should happen in response to some event or new policy, and what would happen in the future. Positive economics tries to explain why economic growth happens. Normative economics goes further to recommend particular policies that encourage a desired amount (or type) of growth.

Interpreting the observations

Def^n: Econometrics: The use of economic theory, mathematical methods and statistical techniques to analyse economic phenomena

Difficulties in interpreting economic data:

One reason that economics is often difficult is the nature of the data to be interpreted. In economics, any measure that can vary over a range of values is called an economic variable.

- Positive correlation: Two variables move in the same direction
- Negative correlation: Two variables move in opposite directions

Def[n]: Variable: Something that can change over a range of values; something that does not remain constant

Def[n]: Causation: A relationship of cause and effect between variables in which one variable is a determinant of another variable

Just because there is a correlation between two variables does not mean that one caused the other. Correlation means that one event is usually observed to occur along with another. Causation means that one event brings about another event. Correlation does not necessarily imply causation.

Chapter 2: Macroeconomics: Getting started (week 2)

Real GDP over time

Def^n: Real GDP: A measure of the value of all goods and services newly produced in the economy during a specified period of time, adjusted for inflation

Def^n: Inflation: The increase in the overall price level over time

Over the long term, increases in real GDP demonstrate an upward trend, which economists call long- term economic growth. In the short term, there are economic fluctuations, which are more transient increases or decreases in real GDP over a few years.

Def^n: Economic growth: The upward trend in real GDP, reflecting expansion of the economy over time

Def^n: Economic fluctuations (business cycles): Swings in real GDP that lead to deviations of the economy from its long- term growth trend

The difference between the long- term economic growth and the economic fluctuations can be better seen by drawing a relatively smooth line through the observations of real GDP. Real GDP fluctuates above and below the trend line. When the economy is above trend, there is a boom; when it is below trend, there is a slump. Potential GDP represents the economy when it is in neither a slump nor a boom.

Def^n: Boom: When GDP is above trend

Def^n: Slump: When GDP is below trend

Def^n: Potential GDP: The long- term trend value of real GDP

Economic fluctuations: Temporary setbacks and recoveries:

Def^n: Recession: A decline in real GDP that lasts for at least 6 months

Def^n: Peak: The highest point in real GDP before a recession

Def^n: Trough: The lowest point of real GDP at the end of a recession

Def^n: Expansion: The period from the trough of a recession to the next peak, consisting of a general rise in output and employment

Def^n: Growth recession (slowdown): A reduction in the rate of growth of GDP

Key points about fluctuations:

- Economies sometimes overheat (boom): demand > sustainable supply
- Economies sometimes stagnate (slump): demand < potential/ normal supply
- Other terms for potential/ normal supply are: aggregate supply, trend real GDP, potential real GDP
- During most fluctuations, supply is stable and demand is unstable

Scarcity and choice for the economy as a whole

The Production Possibilities Curve (PPC):

Def^n: PPC: A curve showing the maximum possible combinations of sustainable (or efficient) production of two goods, given the economy's resources and level of technology

Why the PPC shifts:

- If the economy had more inputs, it could produce more of everything
- If producers used new and better methods to turn a given amount of resources into more output, the PPC would shift outwards

Inside, outside and on the PPC:

- Inside the PPC, resources are lying idle or being used wastefully
  - In macroeconomics, when total output falls below what the economy can potentially produce, resources can lie idle for long periods
- When the economy is on the PPC, there is efficiency in the sense that inputs have produced as much output as rational producers would want to produce
- For short periods, the economy can go a little outside the PPC. Total output can overshoot

Explaining the long term trend and short term fluctuations

Def^n: Long term (trend): A period long enough (usually a decade or more) for a trend to emerge or change

Def^n: Short term (fluctuation): The period of departure from a given trend (usually up to a few years)

Two key perspectives: The Classical and the Keynesian:

Mainstream macroeconomics nowadays is a blend of two main perspectives: the Classical and the Keynesian.

Def^n: Classical economics: School of thought that advocates relying on markets

Def^n: Keynesian economics: School of thought that postulates that markets can fail and government intervention can improve macroeconomic performance

Chapter 5: Labour and the macro economy (week 2)

Cyclical, frictional and structural unemployment

Def^n: Cyclical unemployment: Unemployment due to a slump when the rate of unemployment is above the natural rate of unemployment

Def^n: Frictional unemployment: Short term unemployment arising from normal turnover in the labour market, such as when people change occupations or locations or are new entrants

Def^n: Structural unemployment: Long term unemployment due to structural problems such as poor skills or longer term changes in demand or insufficient work incentives in specific industries.

Current unemployment=
Natural unemployment: structural + frictional
                    +
Keynesian unemployment: cyclical