Macroeconomics

Introduction to Macroeconomics

LO1: Recognise that the pursuit of enlightened self-interest is the philosophical justification for the free-market. Although market economies still experience fluctuations in GDP, unemployment and inflation.

- Basic philosophy of free market economics is that pursuit of enlightened self-interest leads to the best outcome for the collective group, society and the economy.
- Adam Smith argued that an economic system without a controlling government allowed people to pursue their ambitions→driving force behind economic improvement.
- The industrial revolution saw the world shift away from the limited development of agricultural civilisations on the back of the growth of capitalism. Businesses, in their pursuit of production of G&S in their self-interest beneficially produces what society demands.
- Large fluctuations in GDP and unemployment in market economies show pursuit of self-interest not always creating best economic outcomes
    - Keyes in 1930s argued households and firms pursued self-interest by increasing savings in expectation of downturns (job insecurity), creating problems for the macroeconomy with lower consumption and demand and less firm investment. Higher savings results in redundancies→households have lower incomes, spend less, production cuts, job losses.
    - GFC
    - What's good for the individual may not be good for the collective
- Thus, when should fiscal and monetary policy intervene to influence decisions and improve outcomes is central to macroeconomics.
- Macroeconomics studies the behaviour of aggregates, represented by the 6 main players.
- All societies make decisions about the allocation of resources at a macro level and between present consumption and future investment.
    - Choice involves trade offs (Opportunity Cost)
    - In making choices, households and firms respond to incentives (Interest Rate)
    - Choices society makes about resources allocated to education, health, consumption and min wages determine outcomes of income distribution

LO2: Recognise that macroeconomics is 2 schools of thought that centre on the extent that fiscal and monetary policy should be used to minimise fluctuations in GDP, unemployment and inflation

Macroeconomics studies the behaviour of the economy as a whole including the behaviour of aggregate measures of unemployment and growth.

History

The traumatic drop in values of world stock exchanges during the Great Depression led people to reduce consumption and firms with lower demand, with unemployment rates of 20% of the labour market. Macroeconomics was developed to understand why employment and production grow and fluctuation over time.

Classical:
Markets work best with limited use of fiscal policy.

Keynesian:
Because of market failure, fiscal and monetary policy can stabilise macroeconomic performance and fluctuations in GDP and unemployment in a capitalist economy.

The Goals of Macroeconomics

1. **Full Employment:** All those willing and able to work find jobs
2. **Economic Growth:** Ensures material standards of living rise
3. **Price Stability:** Stable inflation aids individuals in planning future decisions

LO3: Recognise the major players in macroeconomic models

Households:
Biggest contributions to consumption and demand so incentives and decisions made by these players are a central component of models.

Firms (Investment):
Responsible for most investment and are the creators of most employment.

Government (Fiscal Policy):
Perform a range of important functions, purchasing G&S and taxing households.

Central Banks (Monetary Policy):
Issuing the currency, setting the policy interest rate and managing the exchange rate.

Commercial Banks:
Making of loans (and creating money) is essential for functioning of market economy. Yet one of the biggest contributors to downturns (GFC).

International Capital Markets:
Economies interact and exchange G&S through imports and exports.

Given households and firms pursue their self-interest and governments and central banks act in the interests of its citizens, economic statistics are vital for policy making, measuring players' decisions and the outcomes of their decisions.

Economic model is a simplified version of reality that enables us to observe, understand and make predictions about economic behaviour.

LO4: Grasping the basics of economic models

In studying the social problem of choice, economists develop theories in using models of the economy. Models depict features of the economy and describe a general relationship and quantitative relationship.

The connection between economic players (variables in the model) importantly determines systemic relationships and outcomes. Statistical tests measure the question of correlation. Some economists assume disposable income is a major influence on consumption and use this hypothesis to predict the impacts on consumption if income increased.

Ceteris Paribus:
Only 1 player changes its behaviour for economists to make further analysis.

LO6: Understand the differences between positive and normative statements

Positive Economics:
The study of how the economy works. Economists constructing models to predict how the economy will be affected by different policies.

-Eg: Keynesian vs Classical Debate

Normative Economics:
The desirability of various actions. Evaluating alternative policies and weighing the benefits and costs.

-Eg: The extent fiscal and monetary policy should be used