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## Introduction to Macroeconomics

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## Agenda

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- What Macroeconomics Is About.
  - What Macroeconomists Do.
  - Why Macroeconomists Disagree.
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## What Macroeconomics Is About

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- Macroeconomics is the study of:
    1. The structure, dynamic adjustment, and performance of national economies, and
    2. The government policies that affect national economic performance.
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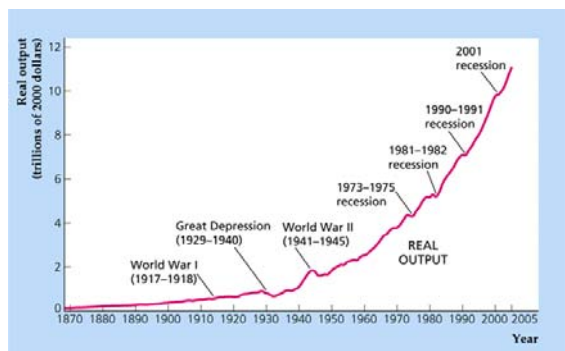
## What Macroeconomics Is About

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- The main issues of macroeconomics are:
    - Long-run economic growth
    - Business cycles/fluctuations
    - Unemployment
    - Inflation
    - The international economy
    - Macroeconomic policy
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**Figure 1.1** Long-run economic growth.



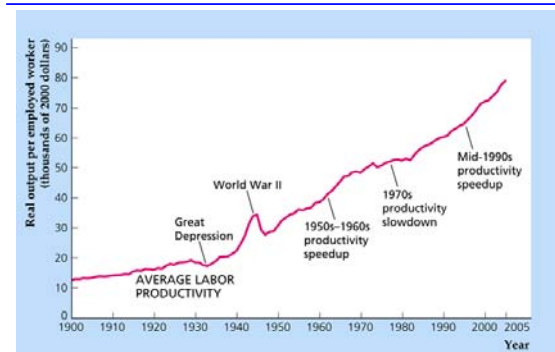
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## What Macroeconomics Is About

- Long-run Economic Growth:
  - Two main sources of growth.
    - Population growth.
    - Increases in average labor productivity.
  - Figure 1.2: Average labor productivity in the U.S.
    - Average labor productivity is output per unit of labor.

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**Figure 1.2** Average labor productivity.



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## What Macroeconomics Is About

- Average labor productivity growth:
  - About 2.5% per year from 1949 to 1973.
  - About 1.1% per year from 1973 to 1995.
  - About 2.0% per year from 1995 to 2005.

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## What Macroeconomics Is About

- Business cycles or fluctuations:
  - Business cycles are the short-run contractions and expansions in economic activity.

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## What Macroeconomics Is About

**Danger ahead**  
*The prospect of recession  
again confronts America*

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## What Macroeconomics Is About

### **Consumer Spending Shows a Sharp Dropoff**

By MICHAEL BARBARO  
and LOUIS UCHITELLE  
Strong evidence is emerging  
that consumer spending, a bul-  
wark against recession over the  
last year even as energy prices  
rised and the housing market

**Americans at Every  
Income Level Are  
Feeling Pinched**

According to the firm's polling,  
Even wealthier consumers,  
who were seen as invulnerable to  
rising gasoline prices and falling  
home values, are feeling the  
squeeze.  
"People are clearly concerned  
that we are headed into a re-

**Economy Hit  
As Consumers  
Tighten Belts**

*Firms Signal Concern  
Over Late Payments;  
'The Teeth of the Storm'*

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## What Macroeconomics Is About

- Unemployment:
  - Unemployment is the number of people who are available for work and actively seeking work but cannot find jobs.

- Figure 1.3: The U.S. unemployment rate.

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**Figure 1.3** The U.S. unemployment rate.



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## What Macroeconomics Is About

### Jobless rise fuels recession fears

Payroll figures brought sharp dip in equities. Data intensity rate. recession in December, another month and bond yields have risen on the Federal Reserve's cut interest rates by at least 25 basis points and possibly to 4 1/4% as the price remains flat.

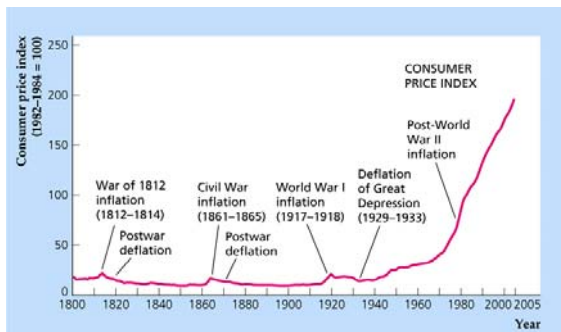
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## What Macroeconomics Is About

- Inflation:
  - Inflation is a persistent rise in the general price level.
    - Hyperinflation is an extremely high rate of inflation.
    - Deflation is a persistent decline in the general price level.
  - Figure 1-4: Consumer prices in the U.S.

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**Figure 1.4** Consumer prices in the U.S.



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## What Macroeconomics Is About

### Fed's Inflation Fears Might Trump Calls for Another Big Rate Cut

Monetary-Policy Makers Appear to Have Less Room To Maneuver Than in Past

Mr. Greenspan, who retired last year, said in a recent interview that inflation risks are much greater today than in 2001 and thus his successor, Ben Bernanke, has less freedom to shore up the economy with steep rate cuts than he did.

and thus the speed at which the economy could grow without bumping up against capacity constraints. Fed staff that June put the economy's noninflationary "potential growth" rate at 3.4%. Since then, slower growth in both productivity and the labor force has led Fed

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## What Macroeconomics Is About

### Core rate of inflation highlights risks for Fed

Fears of US stagflation rise  
Labour markets remain tight

the end of December, weighing against claims that the US had entered recession in December.  
Most districts reported robust holiday spending and further weakness in

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## What Macroeconomics Is About

- The international economy:
  - Open vs. closed economies:
    - An **open economy** has extensive trading and financial relationships with other national economies.
    - A **closed economy** has limited (or no) trading and financial relationships with other national economies.

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## What Macroeconomics Is About

### Credit Scare Spreads in U.S., Abroad

Loan Terms Tighten For Smaller Businesses; Recipe for Slower Growth

In Retreat  
Percentage change for key indexes:  
yesterday    year-to-date  
-20%   -10%   -5%   0%   U.S.  
2007

Fears of a Recession Spark a Global Selloff; New Pressure on the Fed

A world-wide stock selloff sug-

### World's Markets Plunge On Fear of U.S. Slowdown

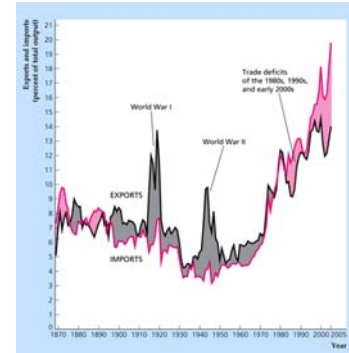
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## What Macroeconomics Is About

- The international economy:
  - Trade imbalances are the differences between exports and imports:
    - **Trade surplus** occurs when exports exceed imports.
    - **Trade deficit** occurs when imports exceed exports.
    - Figure 1.5: U.S. exports and imports.

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Figure 1.5 U.S. exports and imports.



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## What Macroeconomics Is About

- Macroeconomic Policy:
  - Fiscal policy is the decisions made about the levels of government spending and tax rates.
    - Figure 1.6: Federal government spending and taxes.

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Figure 1.6 Federal government spending, taxes.



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## What Macroeconomics Is About

### Bush and Bernanke back fiscal stimulus

White House to unveil plan's 'principles' today  
Fed chief calls \$150bn boost plan 'reasonable'

The prospect of a bipartisan deal brightened as the White House agreed not to link its stimulus proposal to demands that the Bush tax cuts be made permanent. Nancy Pelosi, the Demo-

BUSH PROPOSING \$145 BILLION PLAN TO SPUR ECONOMY

FOCUS IS ON TAX RELIEF

Democrats Say They're Ready to Talk — Few Details Emerge

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## What Macroeconomics Is About

- Macroeconomic Policy:
  - Monetary policy is the growth of money supply, determined by a nation's central bank.
    - In the U.S., the Federal Reserve System or the Fed.

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## What Macroeconomics Is About

### Bernanke ready for aggressive rate cuts

Fed chief determined to avert risk of recession  
Investors expect 50bp reduction this month

The S&P 500 index rallied sharply after his remarks, before giving up some of the gains. Treasury yields gained their earlier rise, while the dollar fell against the euro, trading almost

Fed Chief Opens the Door To 'Substantive' Rate Cuts

FED CHIEF SIGNALS ECONOMY NEEDS MORE RATE CUTS

CITES RECESSION FEARS

Pressure Is Seen Rising for Congress to Act on Stimulus Plan

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## What Macroeconomics Is About

### Fed Cuts Rate 0.75% and Stocks Swing

By MICHAEL M. GRYNBAUM and JOHN HOLUSHA 10 minutes ago

Responding to a worldwide stock sell-off and fears about a U.S. recession, the Federal Reserve slashed its benchmark interest rate before the opening of the U.S. markets.

Fed's Statement | Times Topics Magazine: The Education of Ben Bernanke

### Markets in Flux After Fed Move

By VIKAS BAJAJ and KEITH BRADSHAW 16 minutes ago

U.S. stocks opened sharply



The Standard & Poor's 500 stock index futures pit at the Chicago Mercantile Exchange on Tuesday. Scott Olson/Getty Images

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## What Macroeconomics is About

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- Aggregation:
  - Aggregation is the summing up of individual economic variables to obtain economy-wide totals.
  - This distinguishes **microeconomics** (disaggregated) from **macroeconomics** (aggregated).

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## What Macroeconomists Do

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- Teach macroeconomics.
- Macroeconomic forecasting.
- Macroeconomic analysis.
- Data development.
- Macroeconomic research.

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## What Macroeconomists Do

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- Macroeconomic research:
  - The **goal** is to make general statements about how the macroeconomy works.
    - An **economic theory** is a set of ideas about the economy, organized in a logical framework.
    - An **economic model** is a simplified description of some aspect of the economy.

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## What Macroeconomists Do

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- Usefulness of theory and models depends on:
  1. The reasonableness of assumptions.
  2. The possibility of being applied to real problems.
  3. Whether there are empirically testable implications.
  4. Whether the theoretical results are consistent with real-world data.

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## What Macroeconomists Do

- Developing and Testing Economic Theories:
  1. State the research question.
  2. Make provisional assumptions.
  3. Work out the implications of the theory.
  4. Conduct an empirical analysis.
  5. Evaluate the results.

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## Why Macroeconomists Disagree

- Policy Differences.
- Theoretical Differences.

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## Why Macroeconomists Disagree

- Policy Differences:
  - Economists may have different policy recommendations even if they agree on current economic conditions and the outlook for the economy.

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## Why Macroeconomists Disagree

### Economists Disagree on the Best Approach For Stimulating a Slumping Economy

By STEVEN R. WEISMAN and EDMUND L. ANDREWS

following year to encourage businesses to invest in new plants and equipment.

#### NEWS ANALYSIS



### The Debate Over How and How Long

Some tools that Washington politicians see as ways to counter an economic recession.

Sending money to the states, to keep them from being forced to cut back.	Temporary tax break for business investments — "bonus depreciation" or investment tax credit for corporations.	One-time tax rebate; temporary cut in payroll tax for Social Security, aimed at low- and middle-income workers.	Making the Bush tax cuts permanent.	Extending unemployment benefits beyond six months.	Relief for lower-income families like expanded government health care for children and aid for homeowners facing foreclosure.	Big new spending on infrastructure: highways, mass transit, airports, etc.
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By EDMUND L. ANDREWS

measures that are aimed at low- and mid- 2003 well beyond 2008, when they are

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## Why Macroeconomists Disagree

- Policy Differences:
  - Positive vs. normative analysis:
    - **Positive analysis** examines the economic consequences of a policy.
    - **Normative analysis** determines whether a policy should be used.

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## Why Macroeconomists Disagree

### Economy poised to dominate US presidential race

Recession is bigger concern than Iraq  
Downturn could benefit Bloomberg  
By Edward Luce  
in Washington

"What is new is the degree to which the economy" is now scaring Republican voters," says Charles Cook, a Washington political analyst. "Until very recently it was only Democratic voters who were sounding the alarm bell on the economy."

to another in his widely criticized campaign. "If Romney had based his campaign on competence rather than ideology he would now be leading the field," says Mc Cook. Neither Arizona senator John McCain nor former

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## Why Macroeconomists Disagree

### Bush, Democrats Spar on Stimulus

*Drive for Deal Remains Strong, but Sides Differ On Who Gets Tax Relief*

By JOHN D. MCKINNON,  
DAMIAN PALETTA  
AND SARAH LUECK

WASHINGTON—As President Bush

more. The White House wants tax cuts to help a wide range of individuals and businesses. Privately, it has floated a plan that focuses on rebates of up to \$300 for individuals and \$1,600 for married couples.

In addition to tax cuts, congressional Democrats say they also want spending targeted at specific groups such as the unemployed. They have also discussed denying rebates to taxpayers who earn more than \$85,000

more. The Dow Jones Industrial Average, which has fallen nearly 9% since the beginning of the year, opened higher but lost ground as details of the president's speech emerged. The Dow ended the day down 59.91, or 0.5%, at 12099.30. It shed 4% in the past week.

The central elements of the plan will likely echo the package put in place during the slowdown that followed the end of the dot-com bubble in

### Congress May Act to Boost Growth

*Proposals to Help Economy Could Put Pressure on Bush; Broad or Narrow Measures?*

• **Seeking Solutions:** Democratic lawmakers are drafting legislation intended to boost economic growth, putting pressure on the White House to act.

• **President's Response:** Mr. Bush is

"We're looking at a variety of things, but it's got to have some reach," Sen. Charles Schumer of New York said yesterday, in discussing the Senate's effort for the first time. He called for steps that will give lower- and middle-income consumers

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## Why Macroeconomists Disagree

- Theoretical Differences:
  - Classical economists and Keynesian economists have different views of the structure and dynamic adjustment of the economy.

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## Why Macroeconomists Disagree

- Classicals versus Keynesians:
  - The classical approach:
    - The economy works well on its own.
    - The “invisible hand” is the idea that if there are free markets and individuals conduct their economic affairs in their own best interests, the overall economy will work well.

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## Why Macroeconomists Disagree

- Classicals versus Keynesians:
  - In the classical approach:
    - Wages and prices adjust rapidly to get to equilibrium.
    - One conclusion is that the government should have only a limited role in the economy

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## Why Macroeconomists Disagree

- Classicals versus Keynesians:
  - The Keynesian approach:
    - Observed that during the Great Depression, the classical theory failed because of persistent high unemployment.

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## Why Macroeconomists Disagree

- Classicals versus Keynesians:
  - The Keynesian approach:
    - Keynes concluded that persistent unemployment occurred because wages and prices are slow to adjust so that markets can remain out of equilibrium for long periods.
    - One conclusion is that government should intervene to restore full employment more quickly.

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## Why Macroeconomists Disagree

- Evolution of the Classical-Keynesian debate:
  - Keynesians dominated from WWII to 1970.
  - Stagflation led a classical comeback in the 1970s.
  - Excellent research with both approaches since.

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## Preview: A Unified Approach

- A unified approach to macroeconomics:
  - A single model of the macroeconomy to present both classical and Keynesian ideas.
  - The model is built on 3 aggregate markets—the labor market, the goods market, the asset market.

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## Why Macroeconomists Disagree

- A unified approach to macroeconomics:
  - In the long run:
    - Classicals believe wages and prices are perfectly flexible.
    - Keynesians believe wages and prices are perfectly flexible.
  - In the short run:
    - Classicals assume flexible wages and prices.
    - Keynesians assume wages and prices are slow to adjust.

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## Introduction to Macroeconomics

**The End**



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