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Ch. 1-2

Macroeconomics

↳ decision making of groups

↳ National economy

- Producers
- Consumers
- Savers

Key assumption - SCARCITY

- limited resources,  $\infty$  wants
- market-determined allocation
- gov't policy corrects market errors

Macro Variables

- inflation → price level
- unemployment
- investment + savings
- national GDP
- Wage rate
- interest rate

3 markets

- market for production
- market for expenditures
- asset markets

Key policy variables

- inflation - annualized r.o.c. in PL over a period (usually a quarter)
- unemployment - people above a certain age not being paid for employment

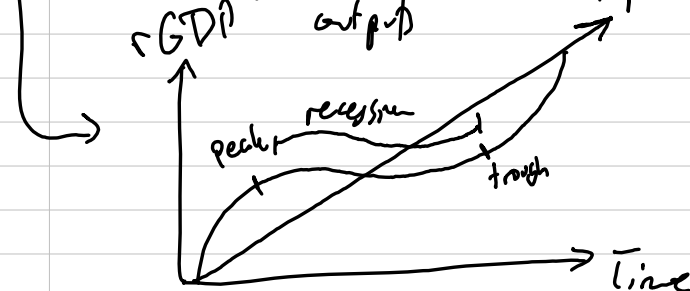
Savings - the amount left over after spending

$$\text{Savings} = \text{Income} - \text{Expenditure}$$

- Dissaving - negative savings

Business Cycle - short run contractions & expansions

Productivity - rate at which inputs are converted to  
GDP output



Recession - 2 consecutive quarters of negative GDP growth

- recessions cause unemployment to rise generally

Deflation - negative inflation

Inflation rates - % increase in prices

Hyperinflation - extremely high rate of inflation

## International Trade

- open vs. closed economies
- Trade surplus - exports > imports ( $NX > 0$ )
- Trade deficit - imports > exports ( $NX < 0$ )

## Measurement & Structure

3 markets in a macro economy

- Production
- Expenditure
- Income

Any output produced is purchased which becomes income  
 $P = E = I$

Firms function - create income from factors

Capital - Goods not entirely consumed in the process of production

Labor - homogeneous good w/ single wage rate

Production - value added by labor + capital

## Expenditure Approach

$$GDP = C + I + G + X_n$$

Income = Expenditure

People consume  $\approx \frac{2}{3}$  of their income

- Durables - Cars, TVs, etc.
- Non durables - food, clothing, fuel
- Services  
↳ USA is moving towards a service econ.

Investment - Spending for new capital goods

- Volatile
- Business fixed investment
- Residential fixed investment
- Inventory investment

Gov't Spending

- $\approx \frac{1}{5}$  of GDP
- Not all purchased of goods + services
  - transfer payments (ie. SS, welfare)
  - interest payments
- Some for capital goods

Net exports

Exports - Imports

- Exports - domestic goods purchased abroad
- Imports - Foreign goods purchased domestically

Private sector & gov't sector income

↳ Private disposable income = income of the private sector

$$\left\{ \begin{aligned} Y_{PVT} &= (\text{Income earned at home}) + (\text{Income earned abroad}) + (\text{gov't payments}) - \text{taxes} \\ &= Y + NFP + (IR + INT) - T \end{aligned} \right.$$

National Savings

$$S_{\text{nat}} = S_{\text{priv}} + S_{\text{govt}}, \quad S_{\text{priv}} = Y_{\text{priv}} - C$$

$$S_{\text{govt}} = T - IR - INT - G$$

Savings & wealth

$$\begin{aligned} \text{Household wealth} &= \text{Assets} - \text{Liabilities} \\ \text{National wealth} &= \sum_i \text{of all wealth} \end{aligned}$$

Use of private savings

$$S = I + CA$$

$$S = I + NX$$

↳ Govt net income = Taxes - transfers - interest payments

CPI and GDP deflator

↳ substitution bias

- behavior of people over time in an inflationary period

↳ doesn't occur w/ GDP-deflator b/c it's revised

Core vs. overall inflation

Real vs. Nominal interest rates