
The Global Economy

Introduction & Overview



This course is about countries

- Their economic and business environments
- Featuring
 - Data
 - Enough economics to make sense of it

4

Three modules

- Long-term economic performance
 - What are the challenges of running a business in [Argentina | France | Brazil | China | India]?
- Short-term economic performance
 - How's the economy doing?
 - How does it affect my business?
- Economic crises
 - Are there signs of serious trouble on the horizon?
 - What can we do about it?

5

Long-term economic performance

Gapminder

- What do you see?
<http://www.gapminder.org/world/>
(growth, human development index, etc)
- Questions that might cross your mind
 - What do you see?
 - Where are the business opportunities? The challenges?
 - What's going on in [China | India | Argentina | Brazil | ...]?
 - Other thoughts?

7

About participation

- An important part of the class
 - More fun for all of us if you pitch in
- Ways to participate
 - Make a comment
 - Ask a question
 - Share an experience
 - Post a comment or link on Announcements & Discussion

8

About participation

- Guidelines
 - Feel free to disagree --- politely, please!
 - Also with me (I was wrong once)
 - Facts are always good
 - Novices: please ask questions, it helps everyone
 - Experts: don't scare your classmates

9

What's happening?

What's happening?

- Regular feature
- Bring your ideas, I'll bring mine
- Read The Economist
 - Order now if you haven't already

11

What's happening?

- Take your pick
 - Argentina's default: What happened? Who's the villain?
 - Corporate taxes: Should they pay more? Why don't they?

12

What's happening?

- Anything else cross your mind?

13

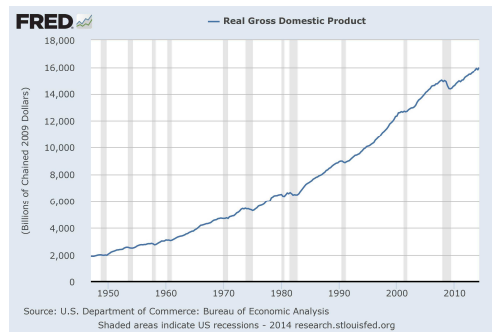
Short-term economic conditions

Current conditions in the US

- How's the economy doing?
- How can you tell?
- What does that mean for your business?

15

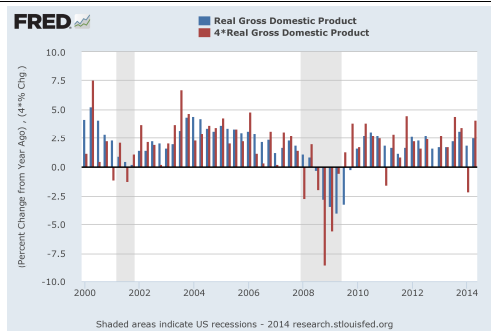
Real GDP



Source: FRED.

16

Real GDP growth (yoy & qoq*4)



17

Current conditions revisited

- What else would you look at?

18

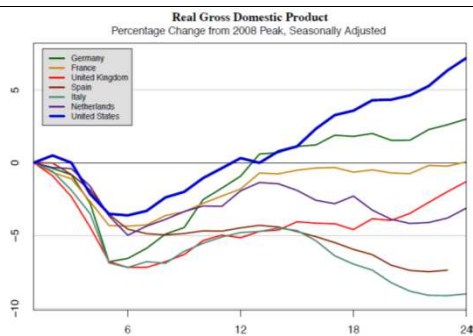
Economic crises

Crises

- What countries are in trouble?
- How can you tell?
- How did they get that way?

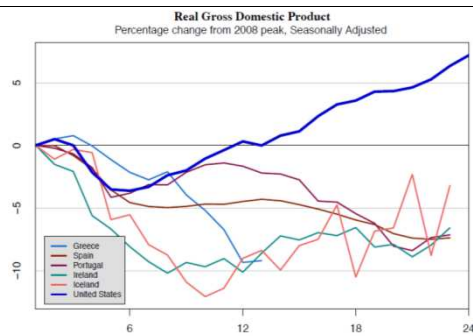
20

European GDP



21

European GDP



22

About the course

About the course

- It's about economic performance
 - Of countries
 - And the businesses in them

24

About the course website

- Everything's on the website:
 - <https://sites.google.com/site/nyusternglobal/home>
 - Or search: #nyuecon global
- The outline contains
 - Topic summaries
 - Assignments (with links!) , slides, video
 - And something extra

25

About Announcements & Discussion

- Access by
 - Signing up for email delivery
 - Or viewing online
- You can use it to
 - Find a group
 - Post comments and links
 - Ask questions about assignments
 - Answer questions asked by others
- I'll use it to
 - Post announcements about the course
 - Answer questions

26

About slides

- Catalyst for class discussion
- Not intended to be read on their own
- More than we need: don't panic if we skip some
- Subject to change without notice

27

About slides

- Catalyst for class discussion
- **Not intended to be read on their own**
- **More than we need: don't panic if we skip some**
- Subject to change without notice

28

About assignments

- Problem Set #0
 - Individual – everyone must do it
 - Math and spreadsheet review
 - Due at the start of our next class
- Problem Sets #1 to #4
 - Do in groups of up to four people
 - Unlimited marriage and divorce
 - Due dates noted in red on website
- Practice Problems A to D
 - Not graded
 - Useful review and preparation for exams

29

About quantitative content

- Course is a mixture of quantitative and qualitative
- Like business
- Like life?

30

About quantitative content

- Spreadsheets
 - Used extensively
 - Read "Math Review" to get up to speed
- Exponents and logarithms
 - Used extensively in first half
 - Read "Math Review" to get up to speed
- Calculus
 - Used a little
 - Not required for exams
 - Read "Math Review" to get up to speed

31

About the book

- Custom designed for this course ("bespoke")
- More focused and concise than most
- Distributed in class for free, also posted online
- Sold by Amazon for \$9
- [Extra credit: write a good review?]
- **Skim before class, read again afterwards**

32

About me

- Grew up in Pittsburgh
- PhD Yale
- Research interests
 - International capital flows
 - Fixed income and currency markets
 - Emerging markets
- Other interests
 - The Steelers
 - Basketball, biking, Buffy, books, beer

33

About John Campbell

- TF/Grader
- Graduate student in economics
- Experienced TF
- A resource for you

34

About getting help

- With problem sets
 - Post questions on Announcements & Discussion
 - Check same to see what others have asked
 - Email me: I'll respond directly AND update Announcements
- With anything else
 - Post a question on Announcements & Discussion
 - Email me
 - Stop by
 - Buy me a beer after class

35

About grades

Participation	Outliers & Tiebreakers
Problem Sets	20%
Midterm Exam	35%
Final Exam	45%

36

About class videos

- Available roughly an hour after class (cross fingers)
- Link on course website (when I track it down)

37

About the syllabus

- Read it, it's a contract between us

38

What have we learned?

As Haiku

Read book before class
If you need help ask for it
Website is knowledge

39

The Global Economy *Macroeconomic Data*

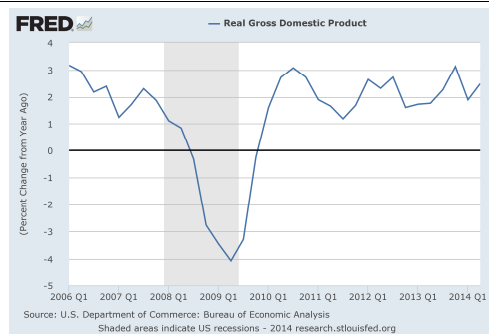


Objective

- Know what these headline numbers are
 - (Real) GDP: how much stuff did we produce? growth rate?
 - Inflation: how much did average prices change?
- Why do we need this?
 - Common vocabulary (like financial statements for businesses)
- Do at high speed now, reinforce with constant use

41

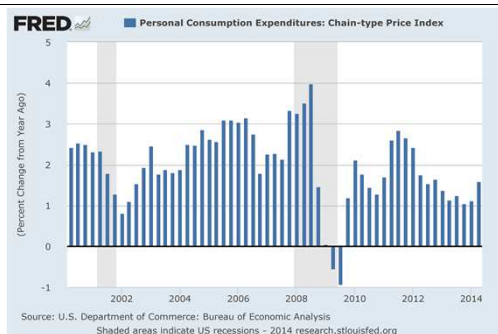
Real GDP (yoy growth rate)



Source: FRED

42

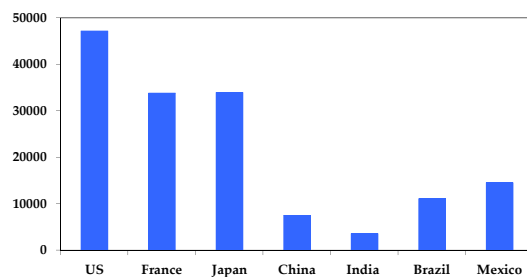
US inflation



Source: FRED

43

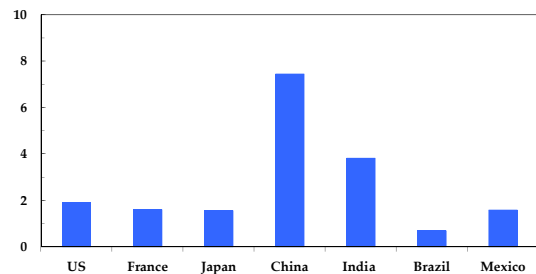
GDP per capita (USD, PPP adj)



Source: World Bank, World Development Indicators

44

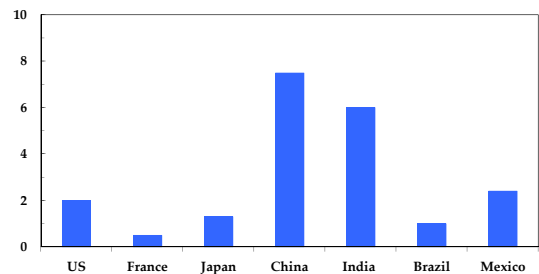
Growth in GDP per capita (20-year avg)



Source: Penn World Tables.

45

Growth in GDP (2014 est)



Source: The Economist.

46

Roadmap

- **GDP: Gross Domestic Product**
- GDP: What the numbers look like
- Expenditures and financial flows ("identities")
- Prices and quantities
- Second thoughts

47

GDP

GDP

- GDP = Gross Domestic Product – and Income
- Standard bottom-line number
- Total value of production in a geographic area
 - Sum value added across all production units
 - By convention we don't subtract depreciation ("gross")
- Three approaches to the same answer
 - Value added ["GDP"]
 - Income (value added is income for someone) ["GDI"]
 - Final sales or expenditures (the end of the value chain) ["GDE"]

49

GDP: example 1

- Example
 - Farmer produces wheat, sells it for 100
 - Miller buys the wheat, produces flour, sells it for 175
 - Baker buys the flour, makes bread, sells it for 300
- What is value-added for each producer?
- What is GDP?
- Who eats the bread?

50

GDP: example 1

Producer	Farmer	Miller	Baker	GDP
Value-added				
Final sales				

51

GDP: example 1

Producer	Farmer	Miller	Baker	GDP
Value-added	100	75	125	300
Final sales	0	0	300	300

52

GDP: example 2

- Barley farmer
 - Sales = 10
 - Rent = 3
 - Farmer's profit = 7
- Brewer
 - Sales = 110
 - Rent = 30
 - Wages = 70
 - Barley input = 10 (COGS)

53

GDP: example 2

Producer	Farmer	Brewer	Total
Value-added			
Income			
Final sales			

54

GDP: example 2

Producer	Farmer	Brewer	Total
Value-added	10	100	110
Income	10	100	110
Final sales	0	110	110

55

GDP: investment & government

- Investment not an input cost
 - Like corporate financial statements
 - Except: we **never** subtract depreciation
- Government purchases valued at cost
 - If the government produces goods and services, we value the output at whatever the input cost is

56

GDP: example 3

- Computer maker
 - Sales = 100
 - Wages = 65
 - Materials = 10
 - Owners' income = 25
 - New building = 15
- What is value added?
- What is income?
- What is final sales?

Concept	CM
Value-added	
Income	
Final sales	

57

GDP: example 3

- Computer maker
 - Sales = 100
 - Wages = 65
 - Materials = 10
 - Owners' income = 25
 - New building = 15
- What is value added?
- What is income?
- What is final sales?

Concept	CM
Value-added	90
Income	90
Final sales	100

58

GDP: example 4

- Government
 - Wages = 75
 - Rent = 25
- What is value added?
- What is income?
- What is final sales?

Concept	Govt
Value-added	
Income	
Final sales	

59

GDP: example 4

- Government
 - Wages = 75
 - Rent = 25
- What is value added?
- What is income?
- What is final sales?

Concept	Govt
Value-added	100
Income	100
Final sales	100

60

GDP: imports & exports

- The issue
 - GDP is what we make
 - Final sales is what we buy ("expenditures")
 - How do we reconcile the two?
- Adjust final sales: add exports, subtract imports
 - Exports are things we make but don't buy
 - Imports are things we buy but don't make

61

GDP: example 2 revisited

- Barley farmer in Canada
 - Sales = 10
 - Rent = 3
 - Farmer's profit = 7
- Brewer in the US
 - Sales = 110
 - Rent = 30
 - Wages = 70
 - Barley input = 10 (COGS)

62

GDP: example 2 revisited

	Canada	US	
Producer	Farmer	Brewer	US Total
Value-added			
Income			
Final sales			

63

GDP: example 2 revisited

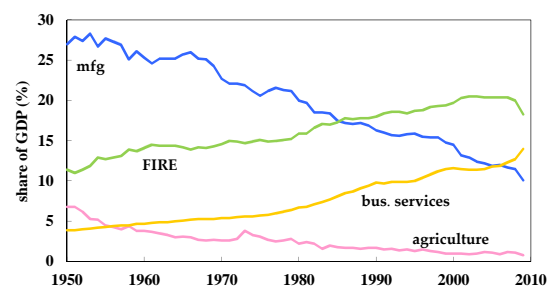
	Canada	US	
Producer	Farmer	Brewer	US Total
Value-added			
Income			
Final sales			

* Remember: subtract imports

64

GDP: The Numbers

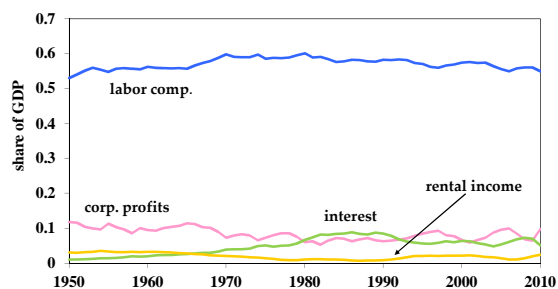
GDP as value added by industry



Source: BEA

66

GDP as income by type



Source: BEA

67

Expenditures & financial flows

Expenditure flows

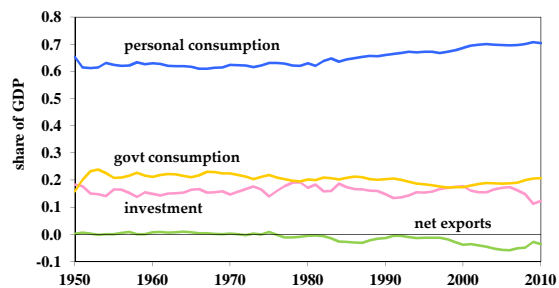
- Allocate GDP among purchasers of final goods:

$$Y = C + I + G + NX$$

- Y = GDP
- C = sales to households ("consumption")
- I = sales of capital goods to firms ("investment" = "capex")
- G = purchases of goods and services by government
- NX = net exports (exports minus imports)

69

GDP as final sales by expenditure



70

Saving and financial flows 1

- Allocate flows of assets

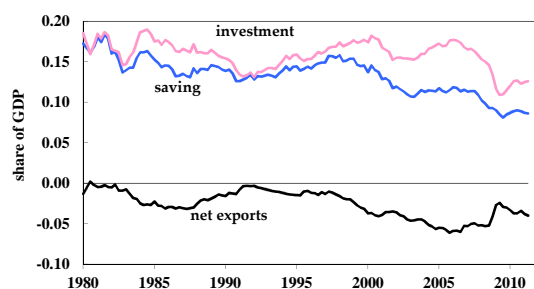
$$Y - C - G = I + NX$$

$$S = I + NX$$

- We're consolidating households and government
- S = gross domestic saving (purchases of assets)
- NX = net purchases of foreign assets

71

US saving and investment



72

Saving and financial flows 2

- Separate household and government

$$(Y - C - T) + (T - G) = I + NX$$

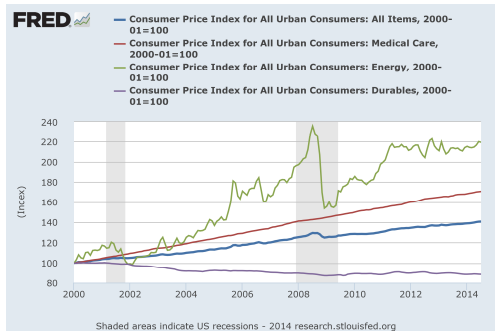
$$S_p + S_g = I + NX$$

- T = taxes net of transfers paid by households to govt
- Warning: many measures of saving, all different
- Call me is this ever comes up

73

Prices & quantities

US consumer prices



75

Prices and quantities

Low ROI activity
Let's move on

- What we've seen so far is "nominal GDP"
 - GDP measured at current prices, in local currency units
- If nominal GDP goes up
 - How much is more stuff? (more "real GDP")
 - And how much higher prices? ("inflation")
- Or ask same question of Wal-Mart's sales
- Problem
 - There's no clear answer
 - Or rather: several answers, equally sensible but different

76

Prices and quantities

- Our problem: find P and Q so that

$$NY = PQ = p_1q_1 + p_2q_2 + \text{etc}$$
 - NY = Nominal GDP = GDP at current prices (a "value")
 - p, q = price and quantity of a specific product
 - P, Q = "average" price ("price level") and quantity ("real GDP")
- Growth rates
 - Of Q: real GDP growth
 - Of P: inflation
- How do we compute P and Q?

77

Prices and quantities

- Method 1 ("fixed price method")
 - Find average quantity Q using "base-year" prices
 - Find "average" price from $P = NY/Q$ ("deflator")
- Method 2 ("fixed quantity method")
 - Find average price P using "base-year" quantities
 - Find "average" quantity from $Q = NY/P$
- Problems
 - Both make sense, but answers are different
 - Choice of base year matters too
 - We don't need to know the details

78

Curing inflation in Argentina

- Voters concerned about inflation
- Former president instituted "new methodology"
 - Only certain products are in the official price index
 - Prices of those products subject to "persuasion"
 - Inflation lower
- What happened next
 - Official products cheap, but not available [why?]
 - Unofficial estimates of inflation more than double official rate
 - Economists arrested for producing private inflation estimates
 - [Search: "inflation Argentina"]

79

Prices in Argentina

- "The IMF and Argentina," The Economist, Feb 9, 2013:



80

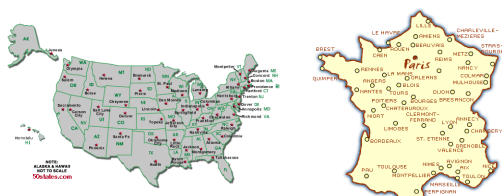
Second thoughts

Do we care about GDP?

- Bill Gates
 - “You can’t eat GDP.”
- Bill Easterly
 - “Mr Gates apparently missed the lecture that listed the components of GDP, such as food.”
 - WSJ, March 2007

82

Do we care about GDP?



Per capita GDP: \$47k
Avg weekly hours: 35

Per capita GDP: \$34k
Avg weekly hours: 29

83

Do we care about GDP?

- The obvious
 - GDP per person reflects income and standard of living
- The less obvious
 - Correlated with many other things we care about: life expectancy, child mortality, poverty
 - Recall [Gapminder](#)
- But it’s one number, not the answer to all questions

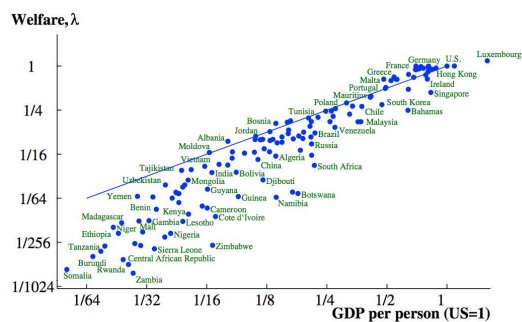
84

Do we care about GDP?

- Jones and Klenow, “Beyond GDP”
 - Compute economic welfare by combining measures of consumption, leisure, mortality, and inequality
 - Result: correlation with GDP per person is 0.95

85

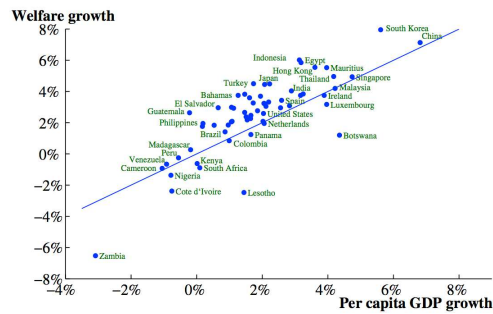
Do we care about GDP? (2000)



Source: Jones and Klenow, “Beyond GDP”

86

Do we care about GDP? (growth, 1980-2000)



87

Fine points

- Home production not counted in GDP
- Black market transactions not counted either
- Some "income" not in GDP
 - Capital gains (houses, equity)
 - Interest on government debt
 - Returns on foreign assets
- Call me if you ever have to deal with this

88

Macroeconomic data

- Caption for old New Yorker cartoon:
 - "Final, revised government figures for the fourth quarter of 1981 now indicate that the Yankees, not the Dodgers, won the World Series."

89

What have we learned?

- GDP measures output, income, and expenditure
 - Per capita GDP is wildly different across countries
 - Labor gets about 2/3, "capital" 1/3
 - Expenditures: $Y = C + I + G + NX$
- Real GDP measures the quantity of output
- Inflation measures the change in average prices
- Macroeconomic data are like sausages

90

Problem Set #0

- Due at start of next class
- Should look professional
- Start now!

91

Something for the ride home

- Should we save more?
- As individuals or as countries?
- Why? Or why not?
- Examples?
- Add your thoughts on the discussion page

92