

The Power of Macroeconomics

**Learn The Principles of Macroeconomics
In a Real World Setting!**

Lecture One: An Overview of Modern Macroeconomics



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Macroeconomics In Our Personal Lives

- Macroeconomics helps you make important decisions:
 - Is it a good time to switch jobs?
 - Should you ask for a raise?
 - Go buy that new house now or wait?
 - Get a fixed or variable rate mortgage?

Macroeconomics in Our Professional Lives

- Macroeconomics helps you make critical business decisions!
 - How much to manufacture?
 - Inventory levels?
 - Invest in new plant and equipment?
 - Expand into foreign markets?
 - Downsize my firm?

The Real Power of Macroeconomics

- Arms us with a new way of thinking about the world we live and work in.
- Helps us filter, sort, and process information that will affect our business decisions.

Seeing Patterns and Trends



Jim Wells' Decision

- Owned a manufacturing business that made high precision components for computer games.
- Jim had to decide how many components to produce for the upcoming holiday season.
- Every year, he had doubled his production.
- Because he never had trouble moving inventory, Jim decided to do the same thing again.
- It meant taking out a big short term loan to finance the expansion.

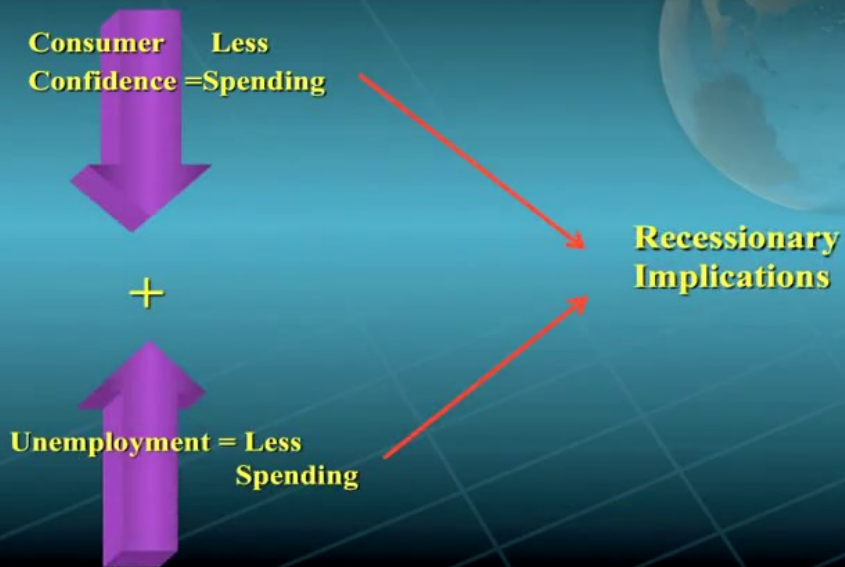
Ignorance is Costly – Not Bliss

- Jim never took a course in the principles of macroeconomics.
- His lack of knowledge would be very costly.
- He missed some significant danger signs.

Look Out Jim! Recession Ahead!



More Warning Signs



Globalization Strikes!



Bankruptcy Looms

- Jim got caught with inventories up and pants down.
- By October, a foreign competitor had taken over half of a market already shrinking fast from the onset of a recession.

Jim's Company – A Turkey By Thanksgiving

- By Thanksgiving, Jim was sitting on a huge inventory that he couldn't give away.
- By December he was unable to pay a huge loan that wouldn't go away.
- By June, Jim's company was bankrupt.

Jim Meets Teresa

- Today, Jim works as a consultant for one of his old Japanese competitors.
- At night, Jim studies macroeconomics.
- He sits in the front row of his class right next to Teresa Watson.

Teresa's American Dream

- A single mother with a dream to own her own home.
- Marketing director for a major corporation.
- With a good salary, she saved up to put a down payment on a new home.

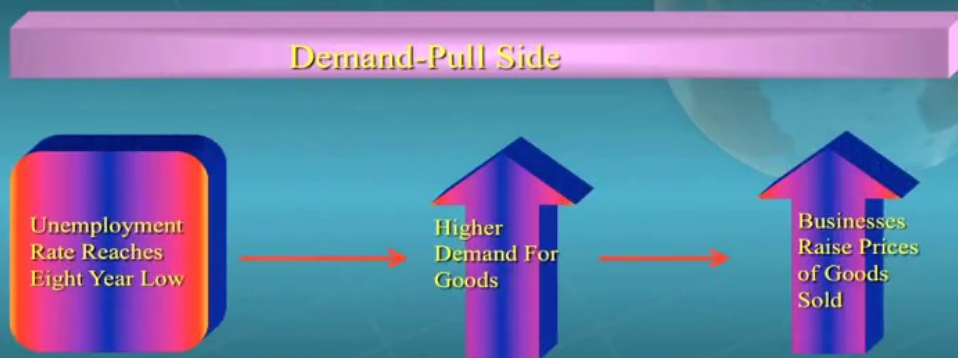
Teresa's Choice – and Gamble!

- A modest condo near work or a big, more expensive dream home out in the suburbs?
- Buying her dream home meant taking a variable rate mortgage two points below a fixed rate mortgage.
- Her variable mortgage payments would be much lower than a fixed rate mortgage – but only if inflation and interest rates stayed low!

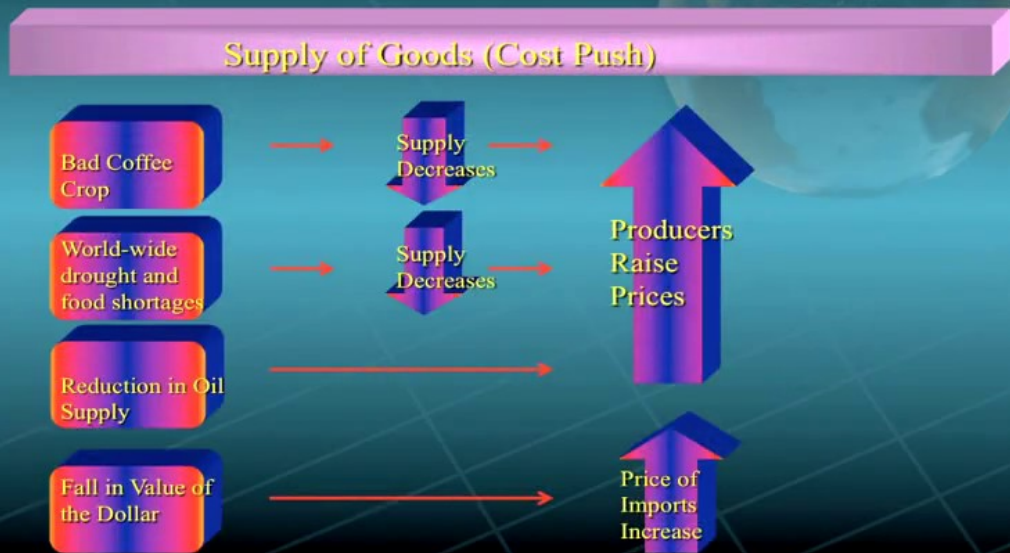
Some Warning Signs

- Teresa felt a little nervous about choosing the variable rate -- but the mortgage banker told her not to worry.
- Rates had been stable so "it shouldn't be a problem."
- However, Teresa failed to see numerous warning signs of growing inflationary pressures.

Inflationary Pressures



Inflationary Pressures



Disaster Strikes

- Interest rates climbed into double digits.
- Teresa couldn't afford her variable rate mortgage payments.
- Rising interest rates plunged the economy into a recession
- The real estate market crashed!
- Teresa was forced to sell her dream home for much less than she bought it for.
- She lost every cent of her equity.

The Power of Macroeconomics in Real Life

- Jim and Teresa could have avoided their hardships with a solid grasp of macroeconomic principles!
 - Jim could have halved his production rather than doubling it and stayed in business.
 - Teresa could have bought that less expensive condo with a fixed rate mortgage.
- Teresa could have even waited until the real estate market went soft and bought her dream house at a discount.

The Dismal Science

- Despite the enormous impact macroeconomics has on our personal and professional lives, most of us view it as a remote, complicated, and indeed “dismal science.”

Thomas Malthus: The man for whom economics was dubbed the “dismal science”



Some Personal History



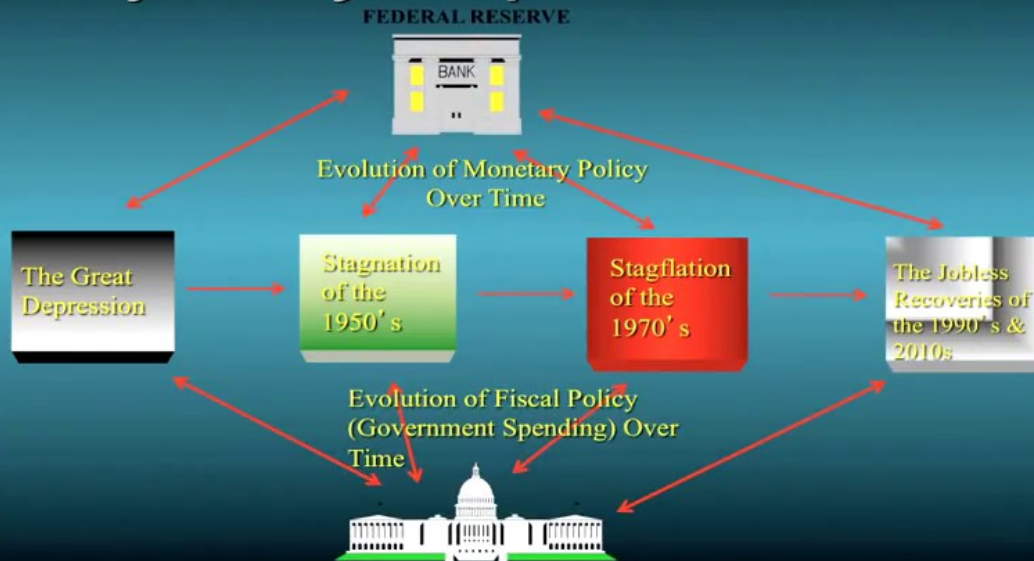
- When I first studied macroeconomics, I got buried in a jumble of graphs and equations.
- My epiphany: The best way to understand the power of macroeconomics is to teach it from an historical perspective.
- Important for at least two reasons.

History Provides a Real World Context For the Study of Macroeconomics



Scenes from the Great Depression

Why History is Important



New Problems – New Complexities

- The problems facing macroeconomists have become progressively more complex over time:
 - Unemployment and inflation
 - Stagflation
 - Stagnating income
 - Chronic budget deficits
 - Persistent trade deficits

How We Will End This First Lesson

- Briefly define macroeconomics.
- Identify key policy issues.
- Provide a short review of macroeconomic history.
 - We'll start with Classical Economics.

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New Theories For New Complexities

- New macroeconomic theories have emerged in response to increasing complexity
- Key turning points in the world's economic history:
 - Keynesianism in the 1930s
 - Monetarism in the 1970s
 - Supply Side economics in the 1980s
 - New Classical economics in the 1990s and 2000s.
 - A new monetary policy of “Quantitative Easing” following the Great Recession of 2007-2008