MFP SET

Lecture 6

Issues in Macroeconomics

Exercise: What is macro?

- Write down what you think are the key economic terms that describe the state of the Australian economy
  - Define these terms
  - Write down what the values of these indicators currently are
  - Would these be the same indicators if you were doing the exercise for the
    - US economy? Japanese economy? Any other Asian economy?

Key economic terms

- Price levels & inflation
- Gross domestic product
- Savings rate
- Interest rates
- Investment
- Economic growth
- Unemployment
- Business cycle(s)
- Government & international accounts
- Budget deficit
- Balance of payments
- Exchange rates
- Levels & types of taxation

Price Level & Inflation

- Price level: refers to the average level of prices in the economy
- Inflation: refers to an upward movement in the average level of prices
- Inflation rate: percentage change in price level over a given period of time (annual)
- *Unanticipated inflation*: changes in the price level that are unexpected
  - can result in redistribution of income, changes in output

Exchange rates

- Exchange rate: price of one currency in terms of another
  - Fixed: exchange rate may be *pegged* to another currency
    - Examples?
  - Floating: exchange rate allowed to fluctuate according to market demand

Gross Domestic Product

- Gross Domestic Output (GDP):
  - a measure of aggregate output for the economy;
  - the value of all *final goods and services* provided in the economy in a year
- Nominal GDP:
  - value of goods and services using prices prevailing at time of measurement or current prices
- Real GDP:
  - value of output using prices of a given or *base* year
    - allows comparisons across years of changes in output; gives a better measure of *economic growth*

Saving & investment

- Saving:
  the difference between income and consumption
- Savings:
  the accumulation of each period's saving

- Investment:
  - "money invested for income or profit" (Penguin English Dictionary)
  - purchase of newly produced capital goods (an economic definition)
  - goods that are produced this year, but not consumed this year
  - goods that can be used in the production of other goods

Economic Growth

- *Expansion* of productive capacity of the economy.
- Measured by changes in *real* GDP
- A ***business cycle*** is a periodic but irregular fluctuation of real GDP around long-term trend

- Caused by:
  - growing labour force
  - growing stock of capital
  - advances in technology (R&D)
  - more efficient use of existing resources

Unemployment

- Unemployment: qualified workers who are available for work, but are not in jobs
  - key determinant: people *looking for jobs*, but not employed
- Unemployment rate: number of people unemployed as a percentage of labour force
- Labour force: total of people employed plus people who are out of work, but seeking jobs

Types of unemployment

- Frictional
- Structural
- Cyclical

Government Accounts

- *Government budget*:
  government sector revenue minus government sector expenditures
  - Revenue obtained from taxes, tariffs, etc.
  - Expenditures on public & social programs
- ➢Government deficit or surplus: excess of spending over revenue or revenue over spending
  - Is a budget surplus a good thing? Now?
- ➢Depends on business cycle, deliberate government policies and international economy

International Accounts

- **External balance***:*
  difference between value of all goods & services that we sell to other countries & value of what we buy from other countries; called the *current account balance.*
- **Balance of Payments**:
  Current account + Capital account

Key questions relevant to business

- What is the level of national income?
- What is happening to prices (in general)?
- What is the rate of unemployment?
- What is the level of growth in the economy
- How do firms make decisions about new plant & equipment?
- How does technological change take place?
  - What effect does it have?
- What determines interest rates?
- What determines exchange rates

Five debates over macroeconomic policy

- That monetary & fiscal policymakers should try to stabilise the economy
- That monetary policy should be made by rule rather than discretion
- That the RBA should aim for zero inflation
- That the government should balance its budget
- That tax laws should encourage saving