

Macroeconomics: Principles & Applications

CHAPTER 5



What Macroeconomics Tries to Explain

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Macroeconomic Goals

- **Macroeconomic goals**

- Economic growth
- Full employment
- Stable prices

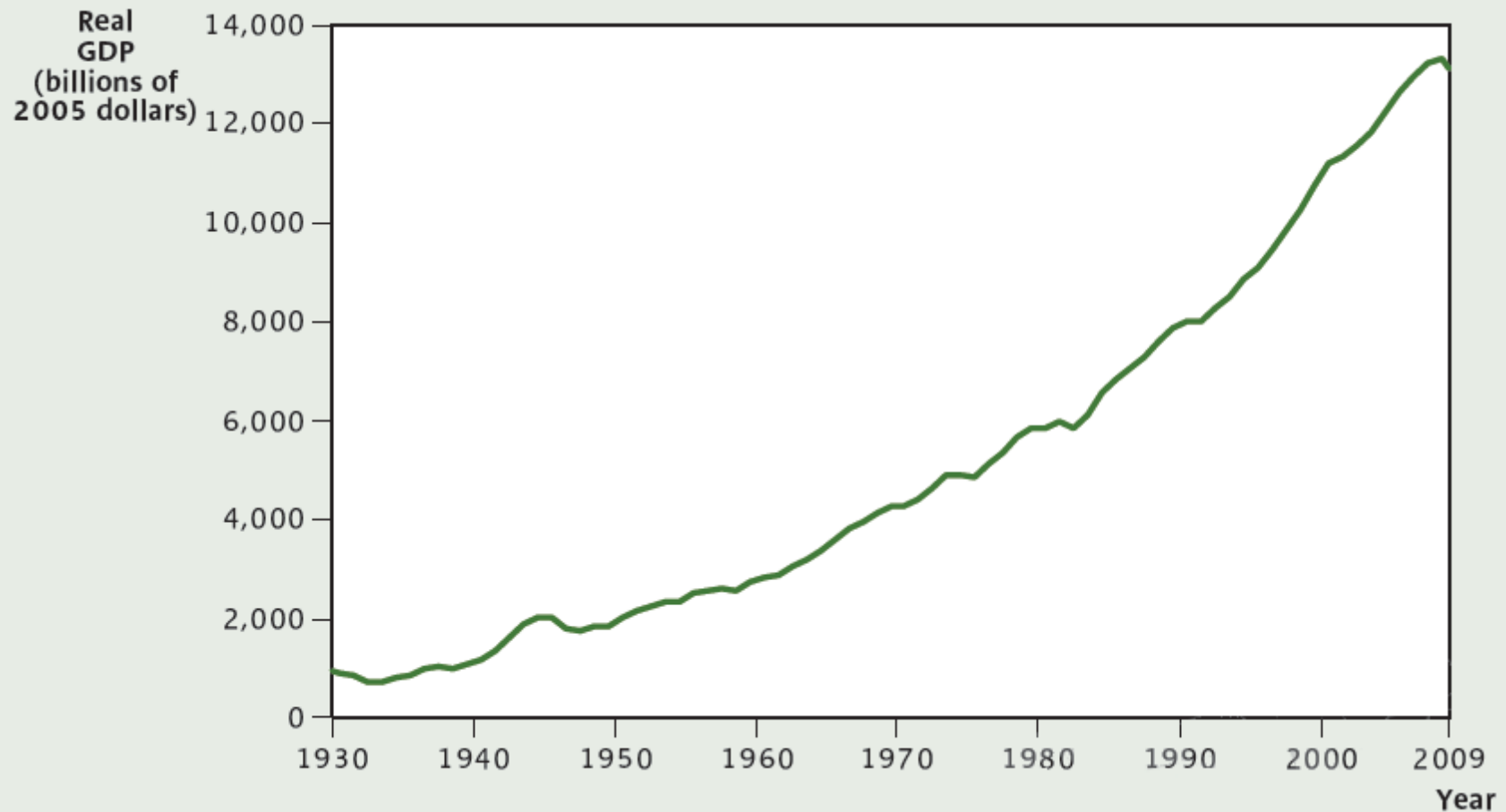
1. Economic growth

- Increase in our production of goods and services
- That occurs over long periods of time

Macroeconomic Goals

- **Real gross domestic product (real GDP)**
 - Total quantity of goods and services produced in a country over a year
- **Higher standard of living**
 - Increase output per person
 - Real GDP rises faster than the population

Figure 1: U.S. real gross domestic product, 1929–2009 (first half of year)



Real GDP has increased dramatically over the past 80 years. In the figure, real GDP is measured in dollars of output valued at 2005 prices. (The measurement of real GDP will be discussed in more detail in the next two chapters.)

Macroeconomic Goals

2. High employment (or low unemployment)

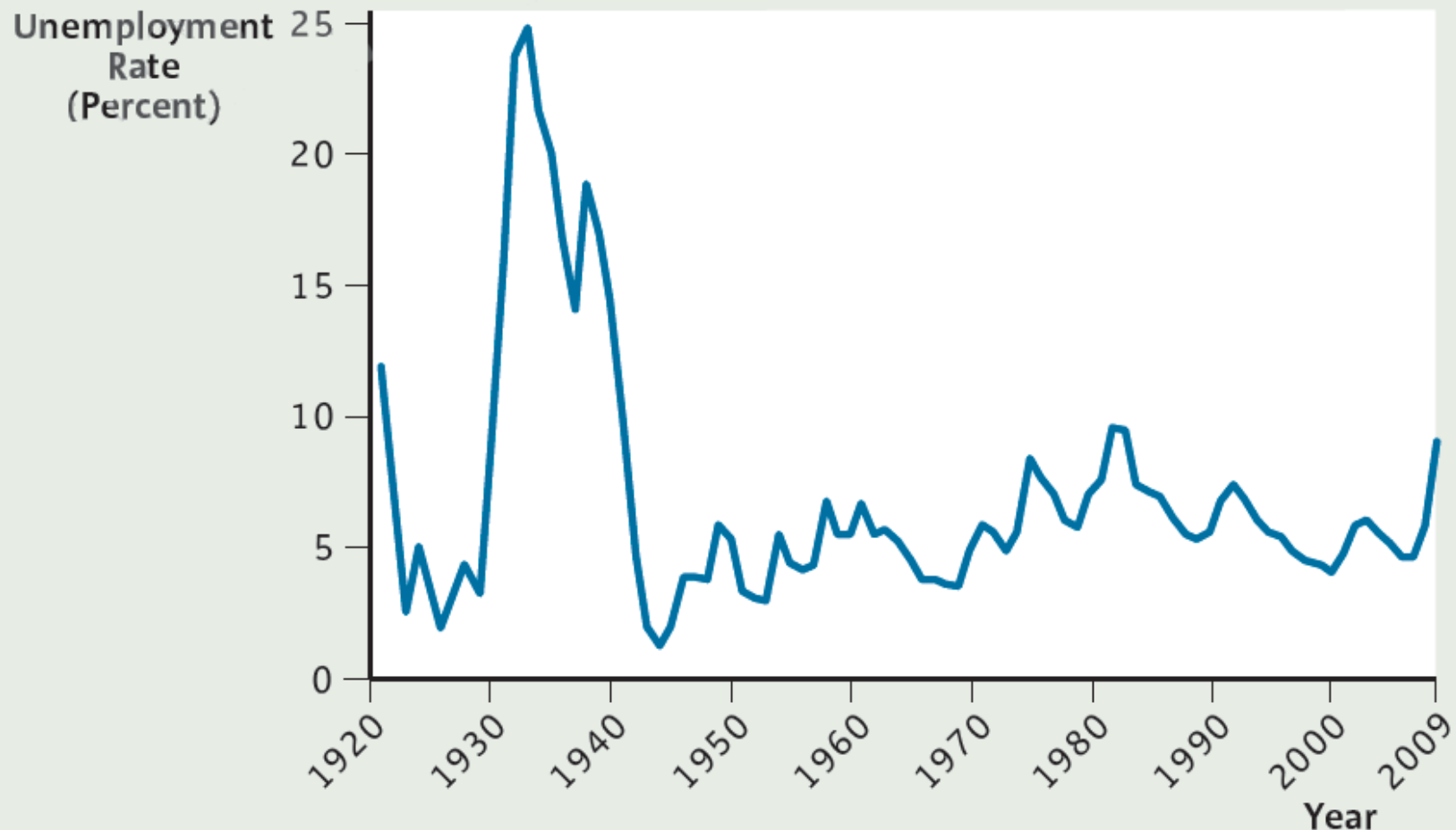
- Unemployment rate

- Percentage of the workforce that is searching for a job but hasn't found one

- Employment Act of 1946

- Federal government - to “promote maximum employment, production, and purchasing power”

Figure 2: U.S. unemployment rate, 1920–2009 (first half of year)



The unemployment rate fluctuates over time. During the Great Depression of the 1930s, unemployment was extremely high, reaching 25 percent in 1933. In the early 1980s, the rate averaged 10 percent. And during the 1990s, it fell rapidly, for two decades, before rising again during the recessions of 2001 and 2008–2009.

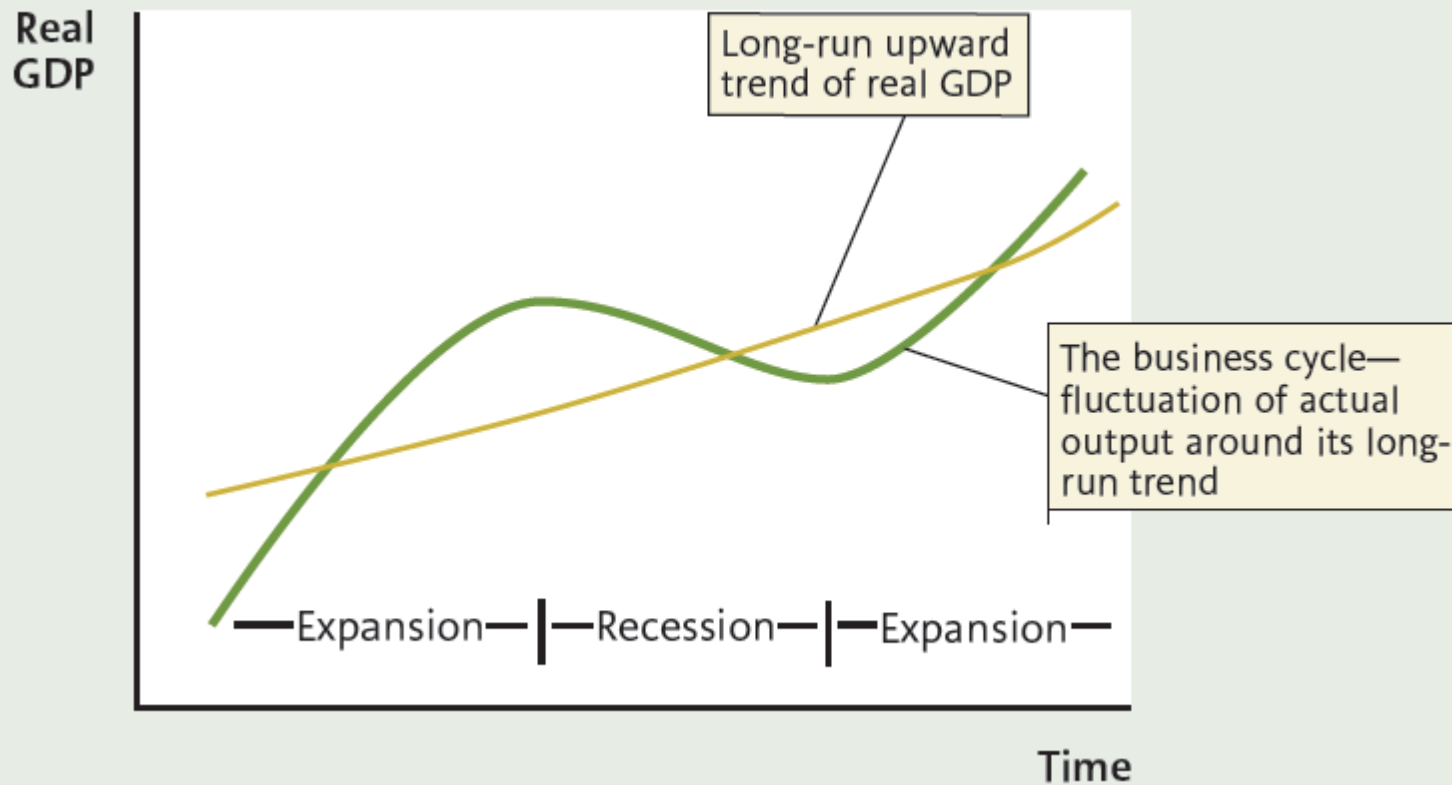
Macroeconomic Goals

- Full Employment and Balanced Growth Act, 1978
 - Called for an unemployment rate of 4 percent
- Business cycles
 - Fluctuations in real GDP around its long-term growth trend
- Expansion
 - Period of increasing real GDP

Macroeconomic Goals

- **Recession**
 - Period of significant decline in real GDP
 - Severe or mild
 - Can last several years or less than a single year
- **Depression**
 - An unusually severe recession
 - 1929-1933
 - U.S. output dropped by more than 25 percent

Figure 3: The Business Cycle



Over time, real GDP fluctuates around an overall upward trend. Such fluctuations are called business cycles. When output rises, we are in the expansion phase of the cycle; when output falls, we are in a recession

Macroeconomic Goals

3. Stable prices

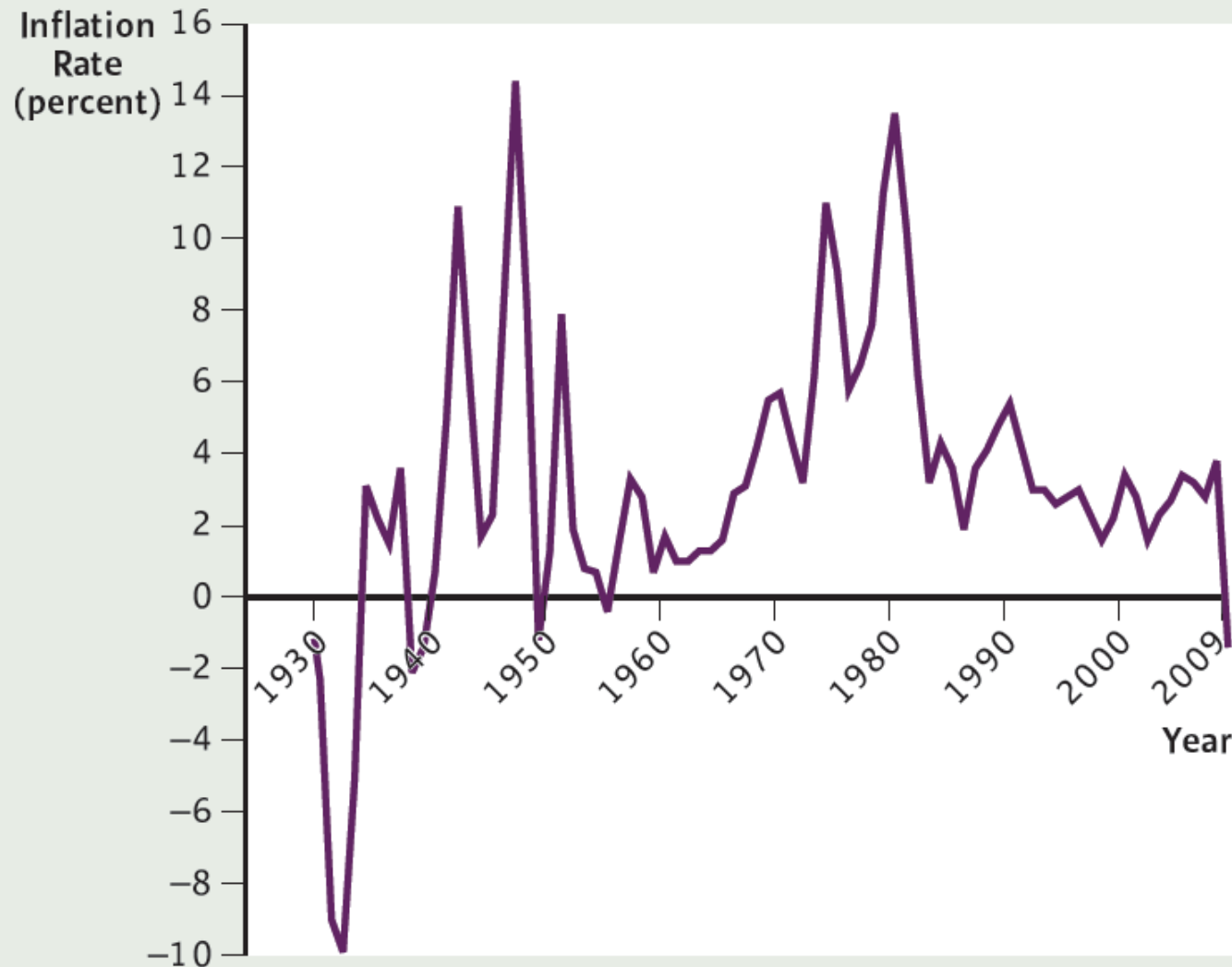
- Inflation rate

- Percentage increase in the average level of prices

- Zimbabwe

- Annual inflation rate $> 100\%$ since 2001
- November 2008: prices doubling every day

Figure 4: U.S. annual inflation rate, 1922–2009 (first half of year)



In most years, the inflation rate has been positive. The overall price level increased during those years.

The Macroeconomic Approach

- **Macroeconomics**
 - Understand how the entire economy behaves
 - Three-step process - applied to all markets simultaneously
- **Aggregation**
 - Combining different things into a single category

Macroeconomic Controversies

- **Classical view**
 - Macroeconomy - worked reasonably well on its own
 - Best government policy: *laissez-faire*
- **Keynesianism**
 - Economy does *not* do well on its own
 - Requires continual guidance from an activist and well-intentioned government