

**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

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**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

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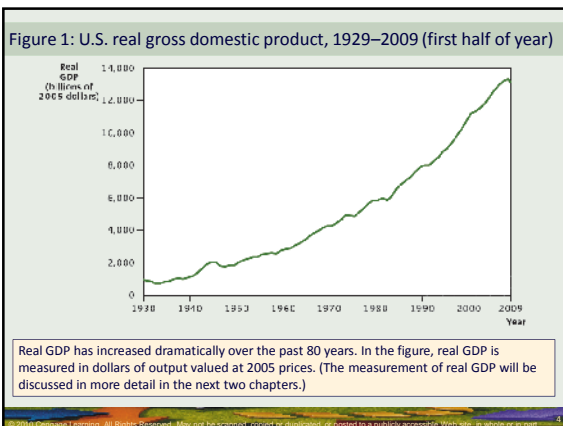
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### Macroeconomic Goals

**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"

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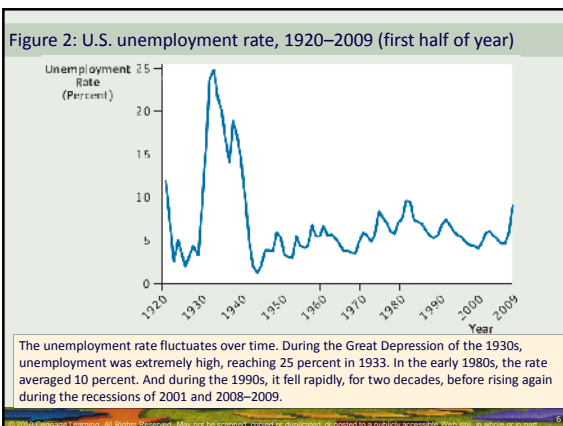
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### Macroeconomic Goals

- **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

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### 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

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**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

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### 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

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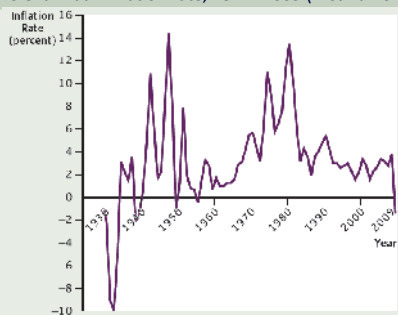
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Figure 4: U.S. annual inflation rate, 1922–2009 (first half of year)



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

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### 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

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### 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

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