National Income & Business Cycles

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1. The Science of Macroeconomics

Defining macroeconomics

- Macroeconomics is the study of the economy as a whole — including growth in incomes, changes in prices, and the rate of unemployment.
- Macroeconomists attempt both to explain economic events and to devise policies to improve economic performance.

Important issues in macroeconomics

- What causes recessions? What is “government stimulus” and why might it help? Can the government do anything to combat recessions? Should it??
- How can problems in the housing market spread to the rest of the economy?
- What is the government budget deficit? How does it affect the economy?
- Why does the U.S. have such a huge trade deficit?
- Why are so many countries poor? What policies might help them grow out of poverty?
Long-term real growth in US GDP per capita 1871–2018

GDP per capita adjusted for inflation using 2005 dollars

Population: 329.3 mil
GDP: @ $21 ($19) trillion
GDP per capita: @ $57,800

U.S. Inflation Rate (% per year)

What do you observe here?

U.S. Unemployment Rate (% of labor force)

Current rate? 3.7% (July 2019)

U.S. Unemployment Rate (% of labor force)
Why learn macroeconomics?

1. The macroeconomy affects society’s well-being.

2. The macroeconomy affects your well-being.
   - Unemployment and earnings growth

3. The macroeconomy affects election outcomes.

<table>
<thead>
<tr>
<th>Year</th>
<th>U rate</th>
<th>Inflation rate</th>
<th>Election outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>7.7%</td>
<td>5.8%</td>
<td>Carter (D)</td>
</tr>
<tr>
<td>1980</td>
<td>7.1%</td>
<td>13.5%</td>
<td>Reagan (R)</td>
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<tr>
<td>1984</td>
<td>7.5%</td>
<td>4.3%</td>
<td>Reagan (R)</td>
</tr>
<tr>
<td>1988</td>
<td>5.5%</td>
<td>4.1%</td>
<td>Bush I (R)</td>
</tr>
<tr>
<td>1992</td>
<td>7.5%</td>
<td>3.0%</td>
<td>Clinton (D)</td>
</tr>
<tr>
<td>1996</td>
<td>5.4%</td>
<td>3.3%</td>
<td>Clinton (D)</td>
</tr>
<tr>
<td>2000</td>
<td>4.0%</td>
<td>3.4%</td>
<td>Bush II (R)</td>
</tr>
<tr>
<td>2004</td>
<td>5.5%</td>
<td>3.3%</td>
<td>Bush II (R)</td>
</tr>
<tr>
<td>2008</td>
<td>7.2%</td>
<td>3.8%</td>
<td>Obama (D)</td>
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<tr>
<td>2012</td>
<td>8.1%</td>
<td>2.1%</td>
<td>Obama (D)</td>
</tr>
<tr>
<td>2016</td>
<td>4.9%</td>
<td>2.1%</td>
<td>Trump (R)</td>
</tr>
</tbody>
</table>

Economic models

...are simplified versions of a more complex reality
- irrelevant details are stripped away

Used to
- show the relationships between econ variables
- explain the economy's behavior
- devise policies to improve econ performance

No one model can address all the issues we care about.
Prices: Flexible Versus Sticky

- Market clearing: an assumption that prices are *flexible* and adjust to equate supply and demand.
- In the short run, many prices are *sticky* - they adjust sluggishly in response to S/D imbalances.
- If prices are sticky, then demand won’t always equal supply.
- Long run: prices flexible, market clears, economy behaves very differently.

- labor contracts that fix the nominal wage for a year or longer
- magazine prices that change only once every 3-4 years

- unemployment (excess supply of labor)
- the occasional inability of firms to sell what they produce