Macroeconomics

First Lecture

(Introduction)

Miscellaneous information

- Course Title: Macroeconomics (Economics II. BMEGT301924)
- Lecturer: Zoltán Bánhidi (zbanhidi@gmail.com)
- Assessment: Two midterm exams, which will include multiple choice and ‘true or false’ questions. Final grades are determined by the average percentage score of the two midterm exams, provided that a student scores at least 40% (16 out of 40) in both exams (otherwise an F grade is assigned).

% achieved	Hunga-rian grade	ECTS equi-valent	Explanation for the Hungarian grade
85-100	5	A	Excellent
70-84	4	B	Good
55-69	3	C	Satisfactory
40-54	2	D	Pass
0-39	1	F	Fail

- 1st Midterm exam (6th Week)
- 2nd Midterm exam (12th Week)

Attendance, grading

- **According to academic regulations, students may miss a maximum of 25% of the classes.**

% achieved	Hungarian grade	ECTS equivalent	Explanation for the Hungarian grade
85-100	5	A	Excellent
70-84	4	B	Good
55-69	3	C	Satisfactory
40-54	2	D	Pass
0-39	1	F	Unfulfilled/Fail

Textbook and student workbook

- Course textbook: Begg, D. – Fischer, S. – Dornbush, R.: Economics. McGraw-Hill.
- Student workbook: Ward D. – Begg, D.: Student Workbook for Economics. McGraw-Hill.
- The textbook is available in limited quantities in the library.

Topics (Macroeconomics)

Topics	Corresponding chapter(s) in the textbook
Introduction to [macro]economics	1, 19
Output and aggregate demand	20
Fiscal policy and foreign trade	21
Money and banking	22
Aggregate supply, prices, and adjustment to shocks	25
Inflation, expectations and credibility	26
Unemployment	27
Exchange rates and the balance of payments	28

Economics

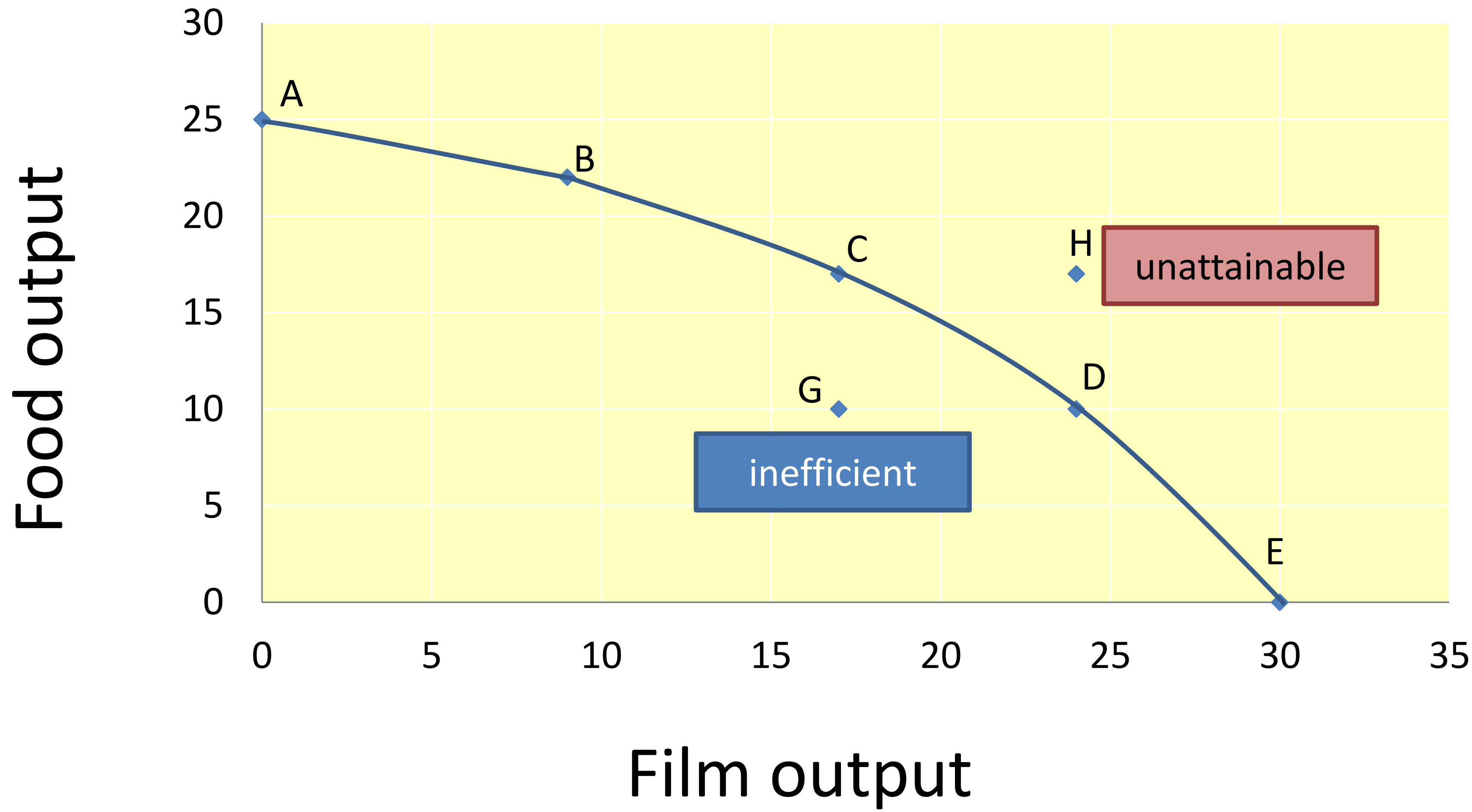
- Economics analyses **what**, **how**, and **for whom** society produces.
- The key economic problem is to reconcile the conflict between people's virtually **unlimited demands** with society's **limited ability** to produce goods and services to fulfil these demands.

Production possibilities

Food		Films	
Workers	Output	Workers	Output
4	25	0	0
3	22	1	9
2	17	2	17
1	10	3	24
0	0	4	30

Trade-off: you can't produce 25 food + 30 films

Production possibility frontier



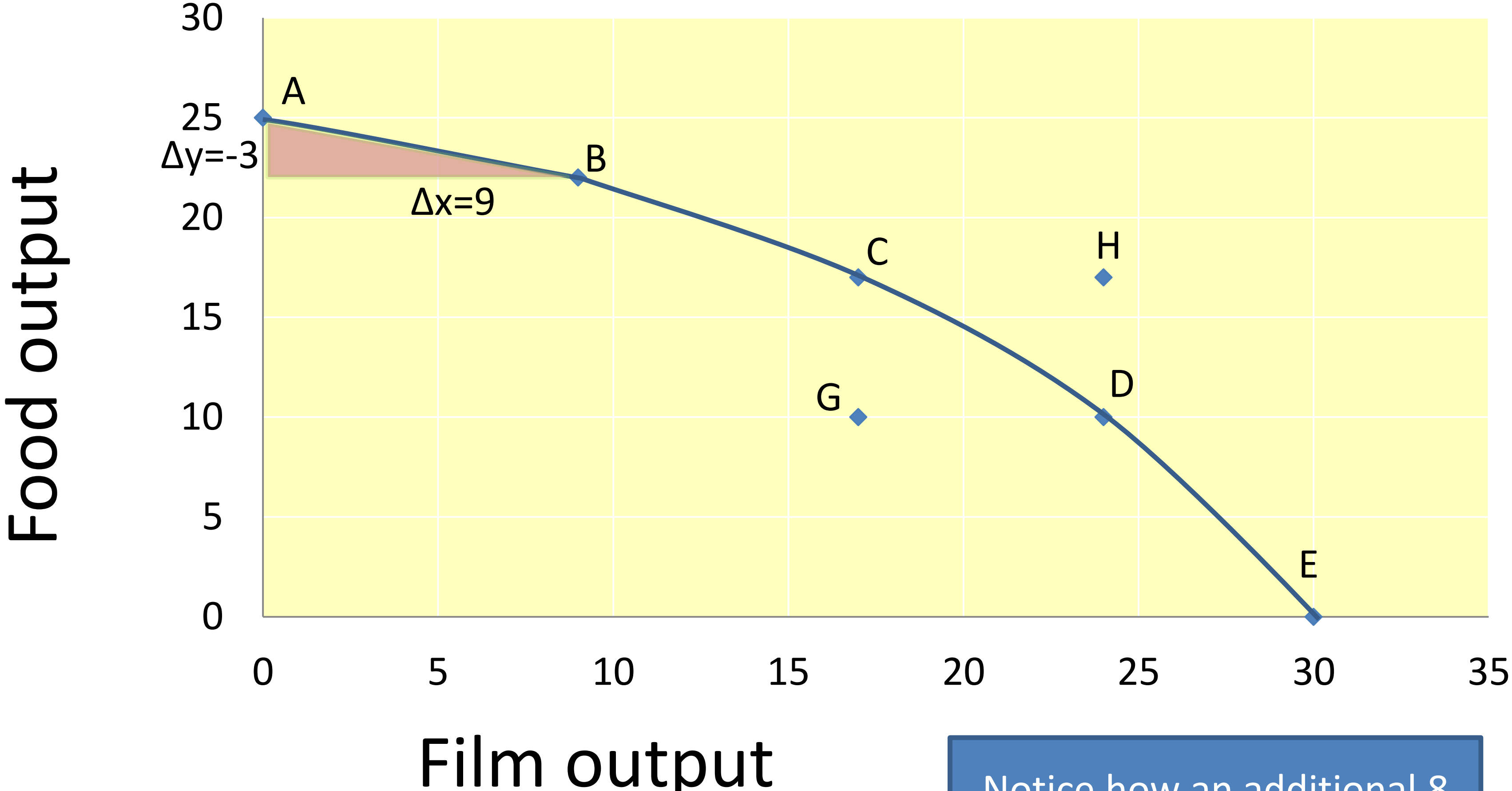
Production possibility frontier (PPF)

- The **production possibility frontier** shows the maximum amount of one good that can be produced given the output of the other good. It depicts the trade-off or menu of choices for society in deciding what to produce.
- Resources are scarce and points outside the frontier are **unattainable**.
- It is **inefficient** to produce within the frontier

Opportunity cost

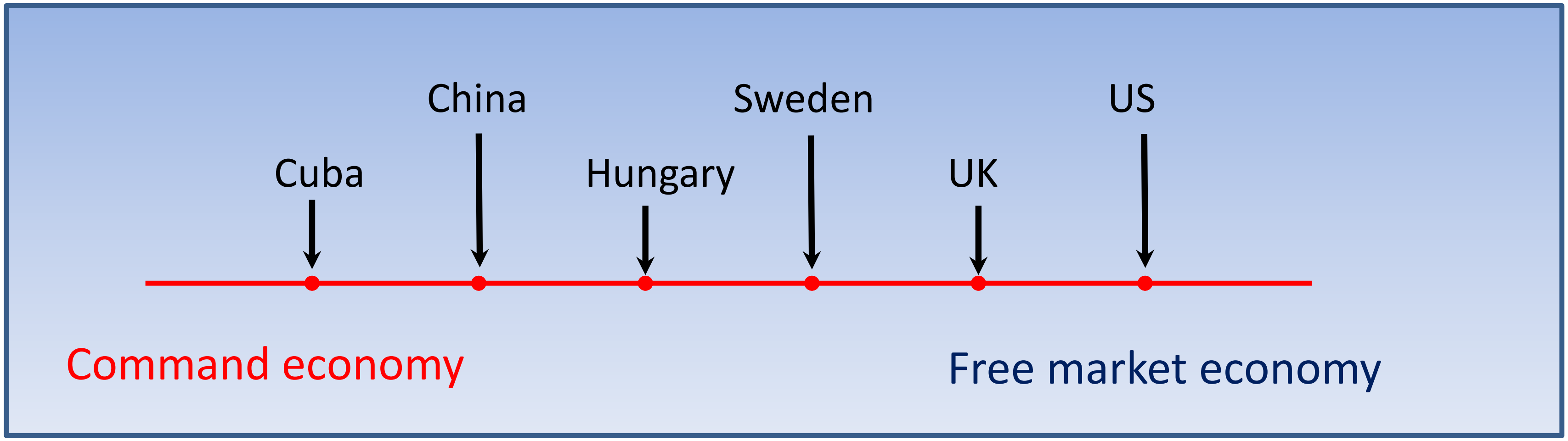
- The **opportunity cost** of a good is the quantity of other goods sacrificed to make an additional unit of the good. It is the slope of the production possibility frontier.
- Suppose we start at point A with 25 units of food but no films. Moving from A to B, we gain 9 films but lose 3 units of food. Thus, 3 units of food is the opportunity cost of producing the first nine films.

Opportunity cost (trade-off)



Notice how an additional 8 films would cost more in terms of food!

Market orientation



In the **command economy** resources are allocated by central government planning. In the **free market economy** there is virtually no government regulation of the consumption, production, and exchange of goods. In between lies the **mixed economy**, where market forces play a large role but the government intervenes extensively.

Positive and normative economics

- **Positive economics** studies how the economy actually behaves. **Normative economics** recommends what should be done.
- The two should be kept separate. Given sufficient research, economists could agree on issues in positive economics. Normative economics involves subjective value judgements. There is no reason why people should agree on normative statements.

Macroeconomics

- **Microeconomics** offers a detailed analysis of particular activities in the economy. For simplicity, it may neglect some interactions with the rest of the economy.
- **Macroeconomics** emphasizes these interactions at the cost of simplifying the individual building blocks.
- **Macroeconomics** is the study of the economy as a system.

The Big Issues

Unemployment

- The **labour force** is people at work or looking for work. It excludes people neither working nor looking for work. The **unemployment rate** is the fraction of the labour force without a job
  - Does **technical progress** destroy jobs?
  - Can the **government** create more jobs?

System of National Accounts:

- **Real gross national product** (GNP) measures the income of an economy, the quantity of goods and services the economy can afford to purchase.
- **Economic growth** is a rise in real GNP.*
- **Gross domestic product** (GDP) measures the output made in the domestic economy, regardless of who owns the production inputs.

Measuring economic activity

Prices and inflation

- The **price level** is a weighted average of the prices households pay for goods and services.
- The **inflation rate** is the percentage increase in the average price of goods and services.
  - What causes inflation?
  - Money growth, oil price rises or a budget deficit?
  - Have we now learned how to defeat inflation?

A closed economy (=not linked to the rest of the world) without a government

- **Households** own the factors of production:
  - Households rent labour to firms in exchange for wages.
  - Households are also the ultimate owners of firms, and get their profits.
  - Capital and land, even if held by firms, are ultimately owned by households.
- **Firms** use these inputs to make output.

The circular flow

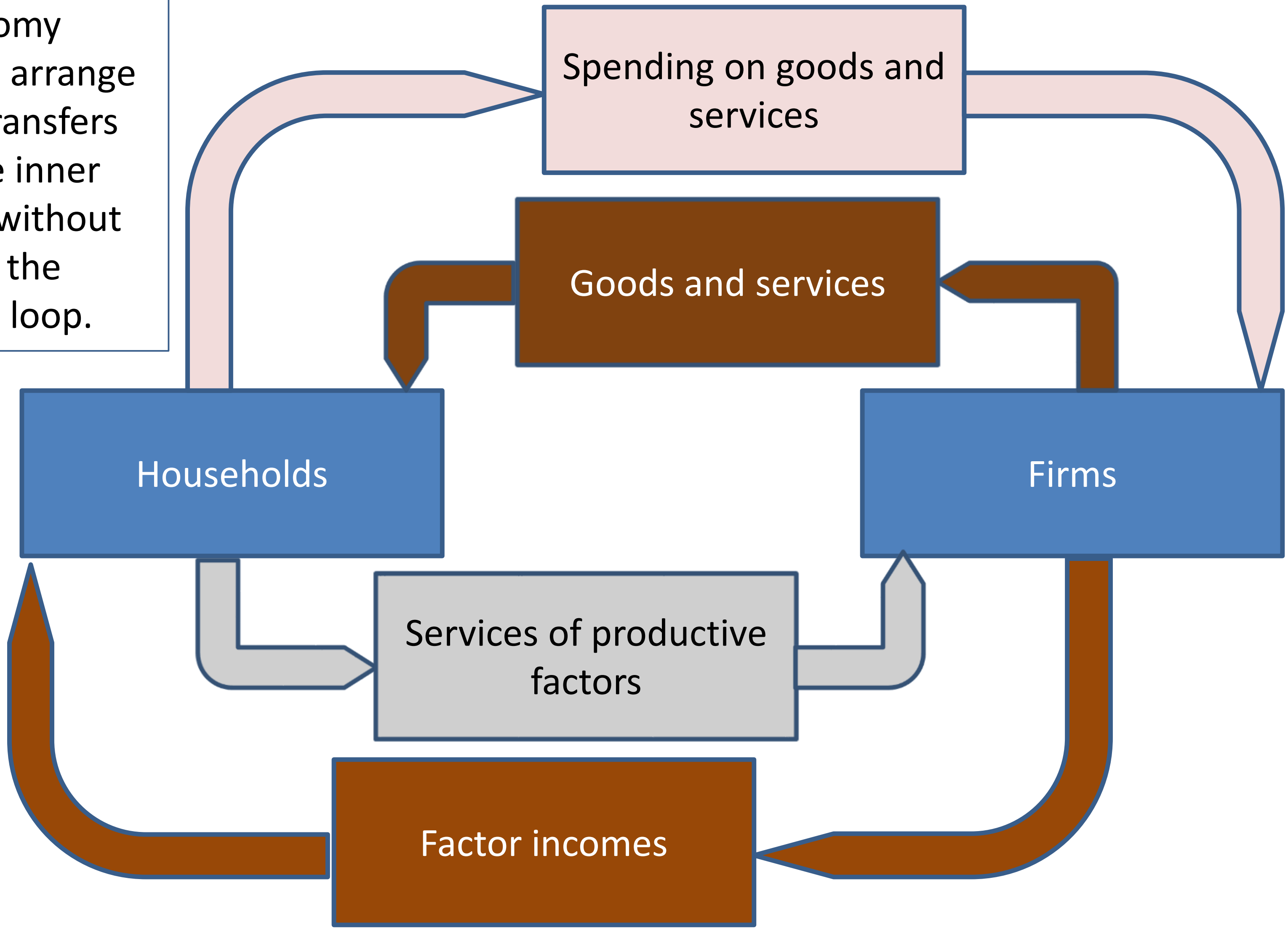
- The **circular flow** shows how real resources and financial payments flow between firms and households.
- The inner loop shows flows of real resources between the two sectors.
- The outer loop shows the corresponding flows of money in a market economy.

Transactions by households and firm

Households	Firms
Supply factor services to firms	Use factors to make output
Receive factor incomes from firms	Rent factor services from households
Buy output of firms	Sell output to households

The circular flow between firms and households

A centrally planned economy could arrange the transfers in the inner loop without using the outer loop.



3 ways to measure economic activity

- The value of goods and services produced;
- The level of factor earnings, which represent the value of factor services supplied;
- The value of spending on goods and services.

<u>In a simple model</u>:

- Factor incomes equal household spending if all income is spent. (What happens if households do not spend all their incomes?)
- The value of output equals total spending on goods and services if all goods are sold. (What happens if firms do not sell all their output?)
- The value of output also equals the value of household incomes. (In a closed economy output and income are the same.)

We will address these complications in a later lecture.