Patrician College of Arts and Science

Department of Commerce

INDIAN ECONOMICS

CDZ2A

Even Semester

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INTRODUCTION TO MICRO AND MACRO ECONOMICS

- ***Microeconomics*** examines the behavior of individual decision-making units—business firms and households.
- ***Macroeconomics*** deals with the economy as a whole; it examines the behavior of economic aggregates such as aggregate income, consumption, investment, and the overall level of prices.

- Microeconomists generally conclude that markets work well. Macroeconomists, however, observe that some important prices often seem "sticky."
- ***Sticky prices*** are prices that do not always adjust rapidly to maintain the equality between quantity supplied and quantity demanded.
- Macroeconomists often reflect on the microeconomic principles underlying macroeconomic analysis, or the ***microeconomic foundations of macroeconomics***.

HISTORY OF MACRO ECONOMICS

- Classical economists applied microeconomic models, or “market clearing” models, to economy-wide problems.
- However, simple classical models failed to explain the prolonged existence of high unemployment during the Great Depression. This provided the impetus for the development of macroeconomics.

- Keynes believed governments could intervene in the economy and affect the level of output and employment.
- During periods of low private demand, the government can stimulate aggregate demand to lift the economy out of recession.
- ***Stagflation*** occurs when the overall price level rises rapidly (inflation) during periods of recession or high and persistent unemployment (stagnation).

Macroeconomic Concerns

- Three of the major concerns of macroeconomics are:
  - Inflation
  - Output growth
  - Unemployment

Inflation and Deflation

- ***Inflation*** is an increase in the overall price level.
- ***Hyperinflation*** is a period of very rapid increases in the overall price level. Hyperinflations are rare, but have been used to study the costs and consequences of even moderate inflation.
- ***Deflation*** is a decrease in the overall price level. Prolonged periods of deflation can be just as damaging for the economy as sustained inflation.

Output Growth: Short Run and Long Run

- The ***business cycle*** is the cycle of short-term ups and downs in the economy.
- The main measure of how an economy is doing is aggregate output:
  - ***Aggregate output*** is the total quantity of goods and services produced in an economy in a given period.

Output Growth: Short Run and Long Run

- A ***recession*** is a period during which aggregate output declines. Two consecutive quarters of decrease in output signal a recession.
- A prolonged and deep recession becomes a ***depression***.
- Policy makers attempt not only to smooth fluctuations in output during a business cycle but also to increase the growth rate of output in the long-run.

Unemployment

- The ***unemployment rate*** is the percentage of the labor force that is unemployed.
- The unemployment rate is a key indicator of the economy's health.
- The existence of unemployment seems to imply that the aggregate labor market is not in equilibrium. Why do labor markets not clear when other markets do?

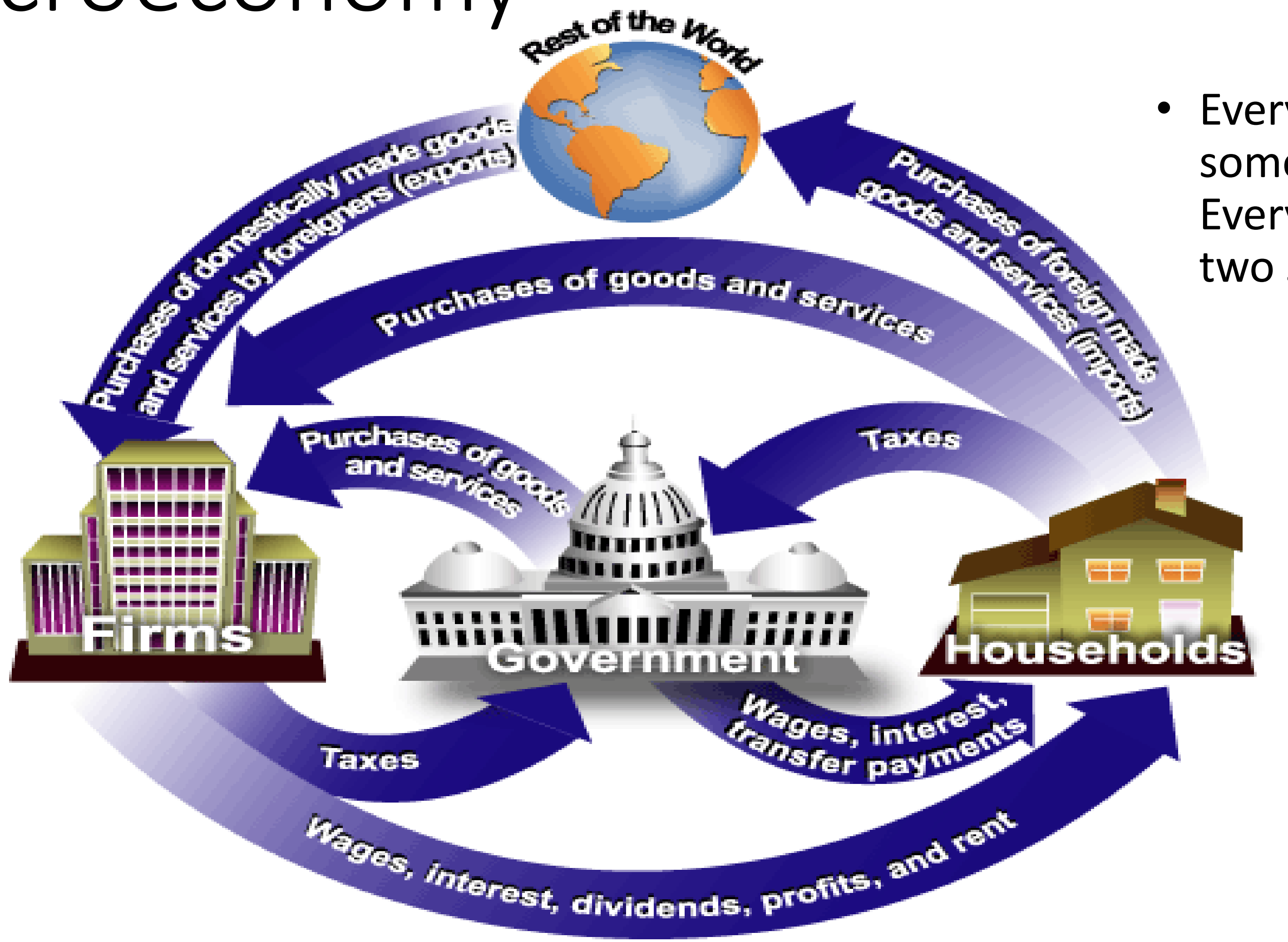
Government in the Macroeconomy

- There are three kinds of policy that the government has used to influence the macroeconomy:
  1. Fiscal policy
  2. Monetary policy
  3. Growth or supply-side policies

Government in the Macroeconomy

- ***Fiscal policy*** refers to government policies concerning taxes and spending.
- ***Monetary policy*** consists of tools used by the Federal Reserve to control the quantity of money in the economy.
- ***Growth policies*** are government policies that focus on stimulating aggregate supply instead of aggregate demand.

The Components of the Macroeconomy



- Everyone's expenditure is someone else's receipt. Every transaction must have two sides.

The Components of the Macroeconomy

- ***Transfer payments*** are payments made by the government to people who do not supply goods, services, or labor in exchange for these payments.

The Three Market Arenas

- Households and the government purchase goods and services (*demand*) from firms in the ***goods-and services market***, and firms *supply* to the goods and services market.
- In the ***labor market***, firms and government purchase (demand) labor from households (supply).
  - The total supply of labor in the economy depends on the sum of decisions made by households.

The Three Market Arenas

- In the ***money market***—sometimes called the *financial market*—households purchase stocks and bonds from firms.
  - Households *supply* funds to this market in the expectation of earning income, and also *demand* (borrow) funds from this market.
  - Firms, government, and the rest of the world also engage in borrowing and lending, coordinated by financial institutions.

Financial Instruments

- ***Treasury bonds, notes, and bills*** are promissory notes issued by the federal government when it borrows money.
- ***Corporate bonds*** are promissory notes issued by corporations when they borrow money.

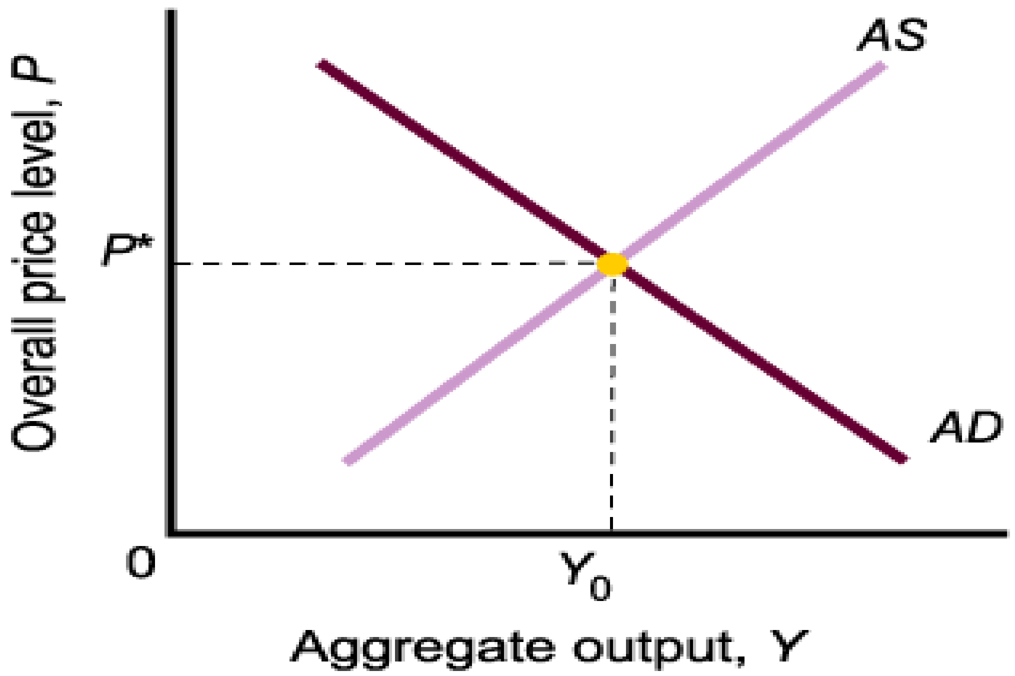
Financial Instruments

- ***Shares of stock*** are financial instruments that give to the holder a share in the firm's ownership and therefore the right to share in the firm's profits.
  - ***Dividends*** are the portion of a corporation's profits that the firm pays out each period to its shareholders.

The Methodology of Macroeconomics

- Connections to microeconomics:
  - Macroeconomic behavior is the sum of all the microeconomic decisions made by individual households and firms. We cannot understand the former without some knowledge of the factors that influence the latter.

Aggregate Supply and Aggregate Demand



- ***Aggregate demand*** is the total demand for goods and services in an economy.

- ***Aggregate supply*** is the total supply of goods and services in an economy.

- Aggregate supply and demand curves are more complex than simple market supply and demand curves.

Thank you

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