# MACROECONOMICS

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PowerPoint® Slides by Ron Cronovich

SEVENTH EDITION

CHAPTER 9.1

# Introduction to Economic Fluctuations

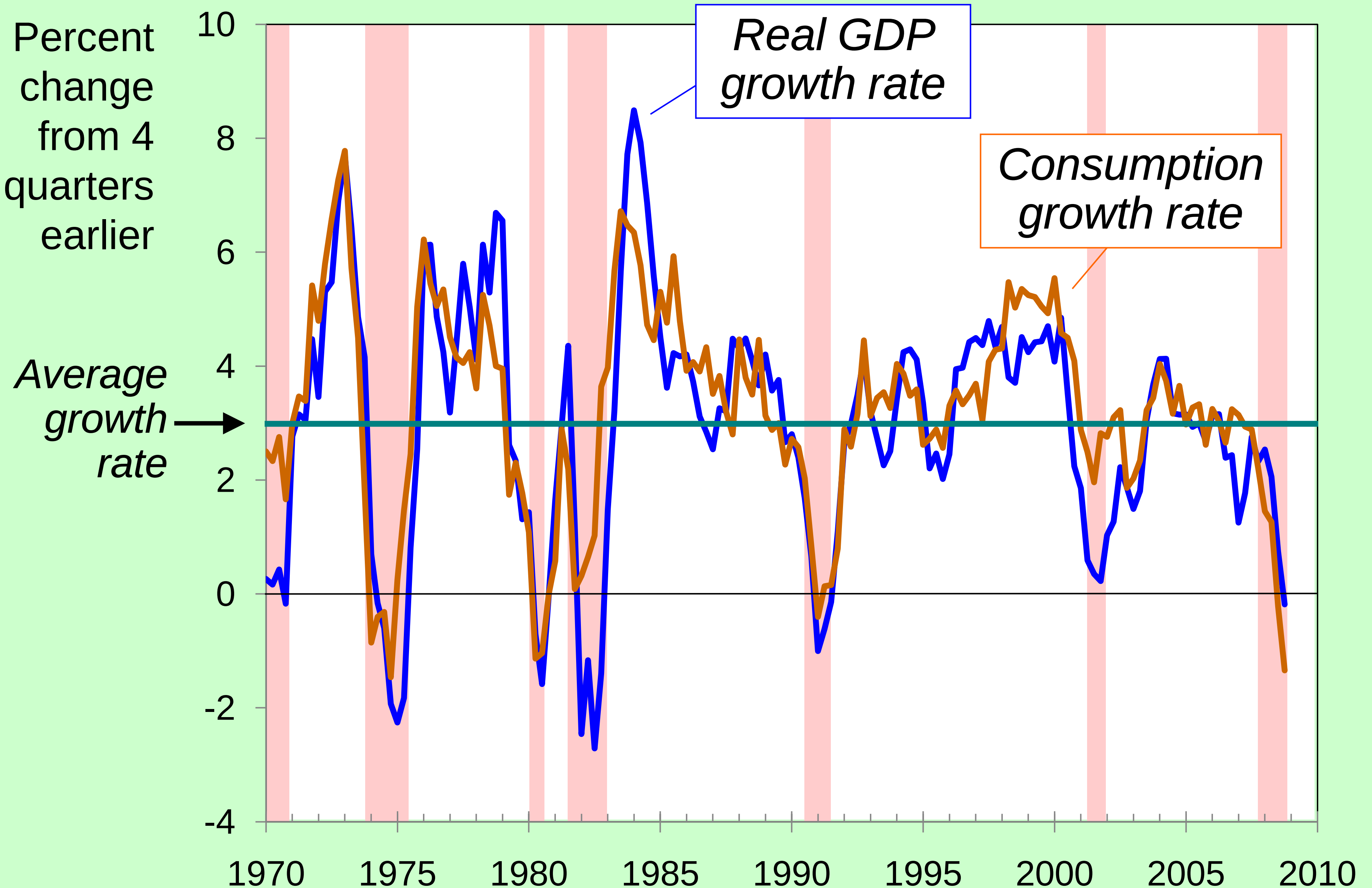
# In this chapter, you will learn:

- facts about the business cycle
- how the short run differs from the long run

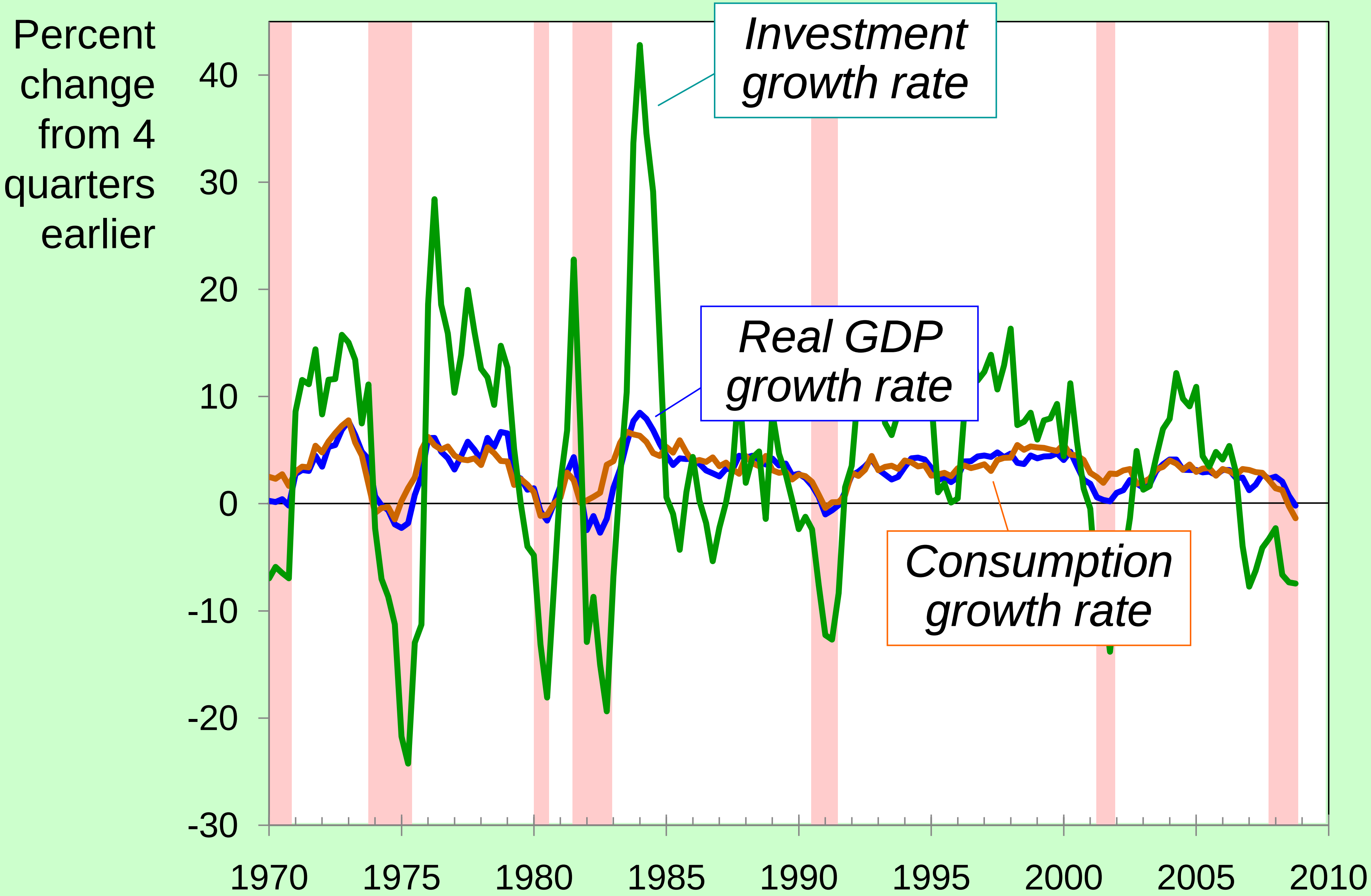
# Facts about the business cycle

- GDP growth averages 3–3.5 percent per year over the long run with large fluctuations in the short run.
- Consumption and investment fluctuate with GDP, but consumption tends to be less volatile and investment more volatile than GDP.
- Unemployment rises during recessions and falls during expansions.
- **Okun's Law**: the negative relationship between GDP and unemployment.

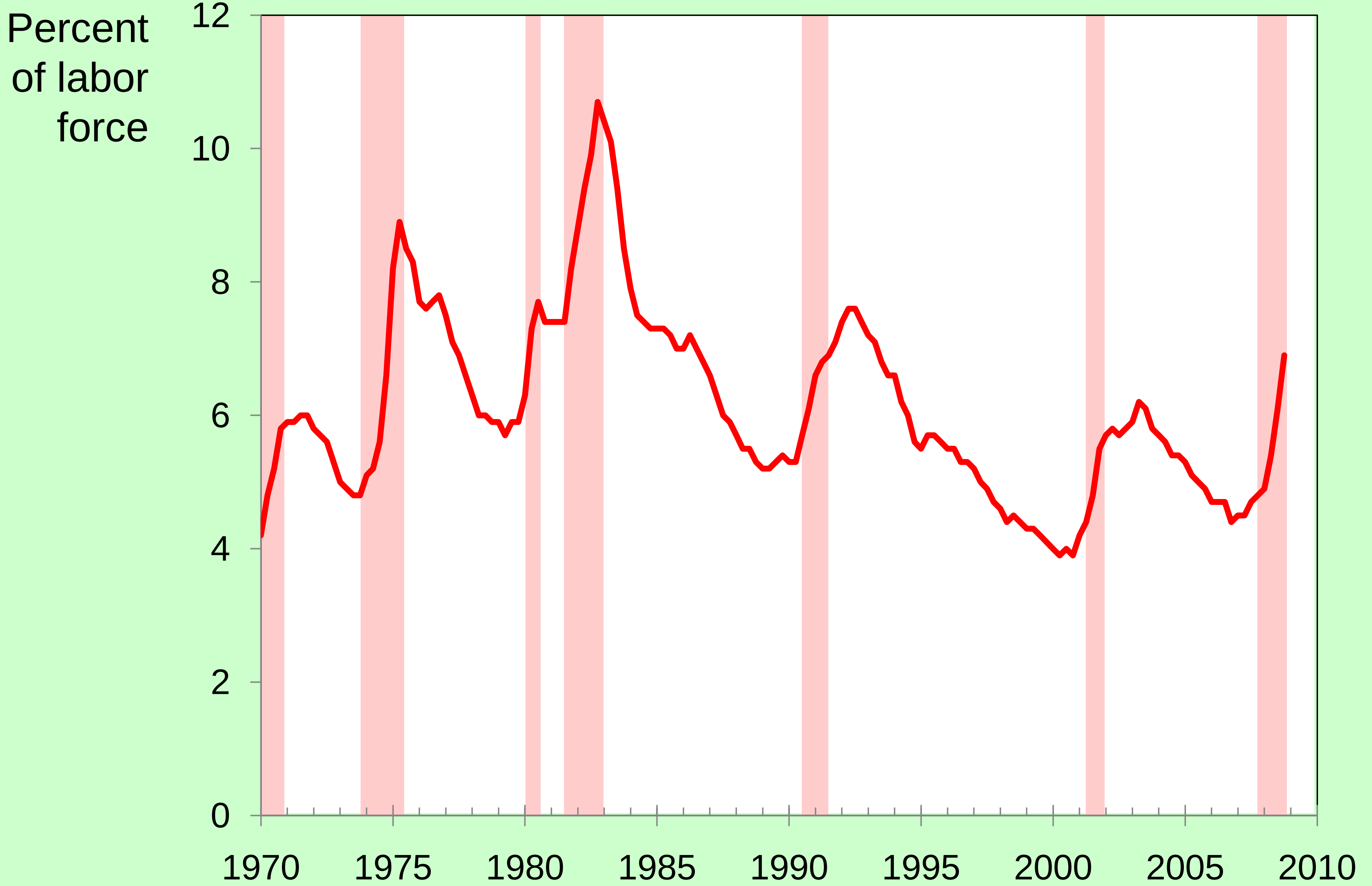
# Growth rates of real GDP, consumption



# Growth rates of real GDP, consumption, investment

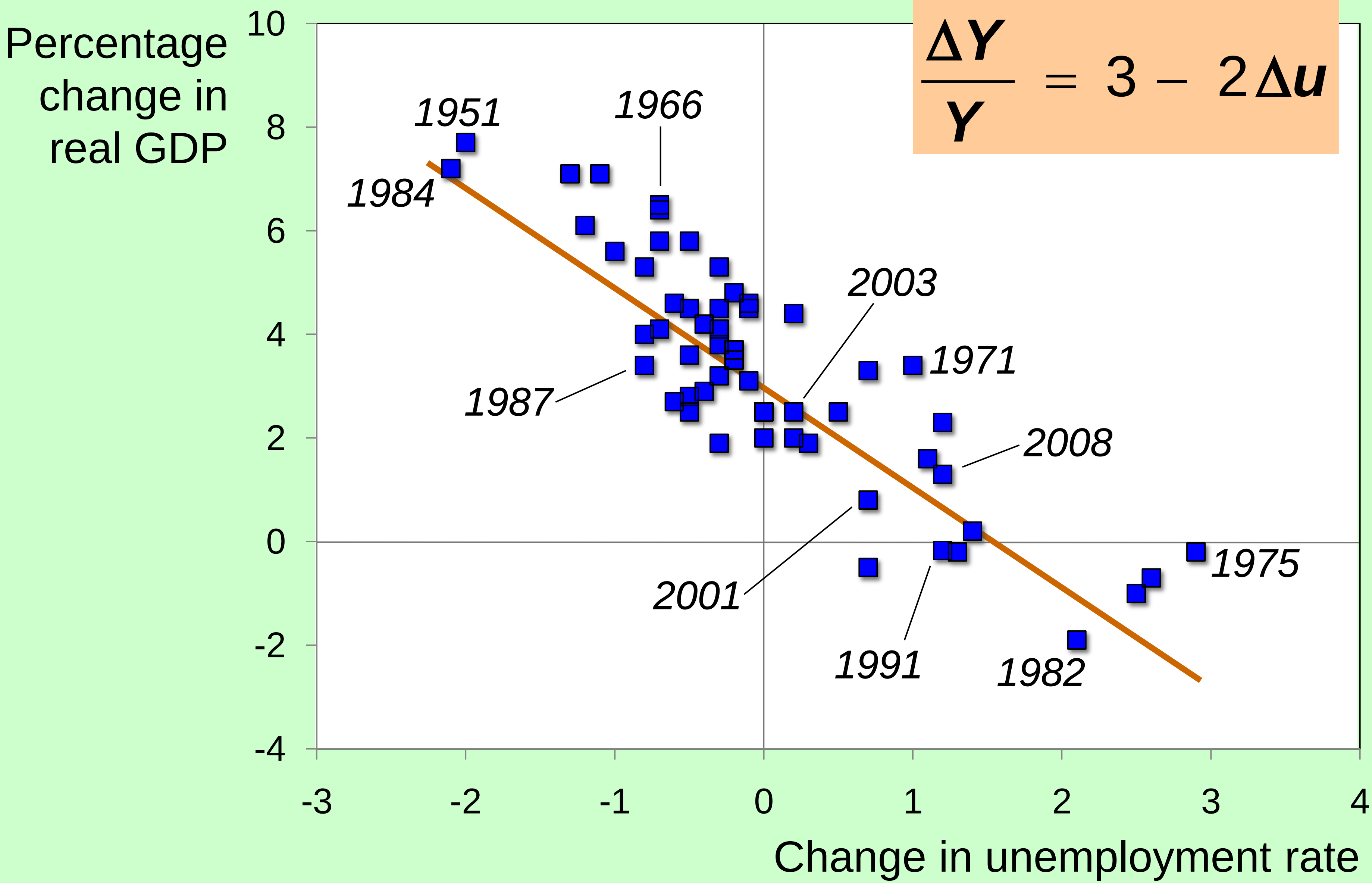


# Unemployment



# Okun's Law

$$\frac{\Delta Y}{Y} = 3 - 2\Delta u$$



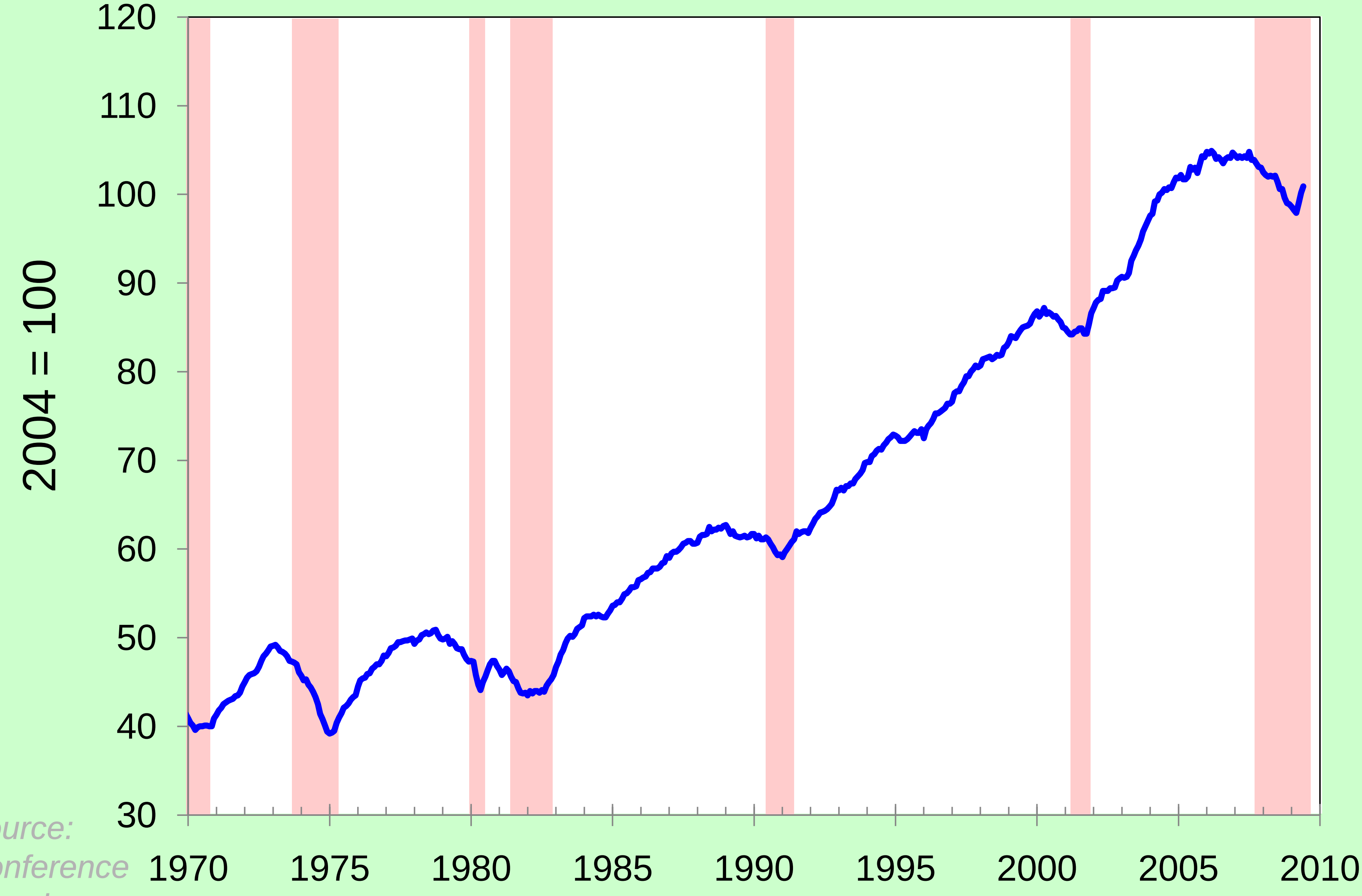
# Index of Leading Economic Indicators

- Published monthly by the Conference Board.
- Aims to forecast changes in economic activity 6-9 months into the future.
- Used in planning by businesses and govt, despite not being a perfect predictor.

# Components of the LEI index

- Average workweek in manufacturing
- Initial weekly claims for unemployment insurance
- New orders for consumer goods and materials
- New orders, nondefense capital goods
- Vendor performance
- New building permits issued
- Index of stock prices
- M2
- Yield spread (10-year minus 3-month) on Treasuries
- Index of consumer expectations

# Index of Leading Economic Indicators




Source: Conference Board

# Time horizons in macroeconomics

- <u>Long run</u>
  Prices are flexible, respond to changes in supply or demand.
- <u>Short run</u>
  Many prices are "sticky" at a predetermined level.

***The economy behaves much differently when prices are sticky.***

# Recap of classical macro theory
## (Chaps. 3-8)

- Output is determined by the supply side:
  - supplies of capital, labor
  - technology
- Changes in demand for goods & services ($C$, $I$, $G$ ) only affect prices, not quantities.
- Assumes complete price flexibility.
- Applies to the long run.

# When prices are sticky…

…output and employment also depend on demand, which is affected by:

- fiscal policy (*G* and *T*)
- monetary policy (*M*)
- other factors, like exogenous changes in *C* or *I*

# Chapter Summary

Long run: prices are flexible, output and employment are always at their natural rates, and the classical theory applies.

Short run: prices are sticky, shocks can push output and employment away from their natural rates.