CPA BEC - STUDY UNIT 6
Macroeconomics:
Core Concepts

A. Three Principal Issues in Macroeconomics

1. **Inflation** is a sustained increase in the **general** level of prices. The **rate of inflation** is calculated by comparing the change in the two years' indexes: the current year price index minus the prior year price index, divided by the prior year price index. **Nominal income** is the amount in money received by a consumer as wages, interest, rent, and profits. **Real income** is the purchasing power of the income received, regardless of how it is denominated. **Demand-pull inflation** is generated by demand outpacing the supply of goods to satisfy it. **Cost-push inflation** is generated by increased per-unit production costs.
2. The **unemployment rate** is stated in percentage terms. The formula used in the U.S. is the number of unemployed divided by the size of the labor force times 100. The **numerator** consists of those who are willing and able to work and who are seeking employment. **Frictional unemployment** is the amount of unemployment caused by the normal workings of the labor market. **Structural unemployment** results when the composition of the workforce does not match the need. **Cyclical unemployment** is directly related to the level of an economy's output. The **natural rate** of unemployment is the sum of frictional and structural unemployment.
3. An economy is in equilibrium when the aggregate demand and aggregate supply curves intersect. **Economic growth** takes place when output and the price level increase. **Fiscal policy** and **monetary policy** are used to stimulate or suppress demand **(demand-side policy)**. The government also can implement policies to increase the stock of investment capital and thus productive capacity to stimulate aggregate supply **(supply-side policy)**.

B. Domestic Output, National Income, and Price Levels

1. Gross domestic product (GDP) is the total market value of all final goods and services produced within an economy during a specified period.
2. The **expenditures approach** to measuring GDP adds the four major categories of expenditures: consumption by households (C); investment by businesses (I); government purchases (G); and net exports (NX). The **income approach** measures each category of the economy's output. **Real per capita output** is GDP divided by population and adjusted for inflation. It is used as a measure of the standard of living.

C. The Business Cycle

1. The tendency toward **instability within the context of overall growth** is the business cycle.
2. The cycle has four phases: peak, recession, trough, and recovery.
3. **Possible causes** of the business cycle are consumer pessimism, disruptive major innovations, and a miscalculation in fiscal or monetary policy.

D. Fiscal Policy

1. The **tools** of fiscal policy used by the government are tax policy, government spending, and transfer payments. If a **recessionary gap** exists, **expansionary policies** stimulate aggregate demand. If an **inflationary gap** exists, **contractionary policies** suppress aggregate demand. The **multiplier effect** is the change in equilibrium GDP from a change in expenditures (e.g., one resulting from use of a tool of fiscal policy). It equals 1 divided by the marginal propensity to save.
2. **Financing a budget deficit**: can be done by raising taxes, issuing debt (e.g., Treasury bonds), or printing money. Borrowing can lead to the **crowding-out effect**. Printing money tends to **devalue the currency**. The budget deficit is the sum of the cyclical deficit and the structural deficit. A **cyclical deficit** results from economic downturns, not government action. A **structural deficit** exists at full employment if no downturn occurs. Thus, it results from government action.

E. Monetary Policy

1. The Federal Reserve System tracks the **money supply**. The primary measures are M-1, M-2, and M-3. **M-1** includes paper money, coins, and checking accounts. **M-2** is M-1 plus savings, time deposits of less than $100,000, and money-market mutual funds. **M-3** is M-2 plus time deposits of $100,000 or more.
2. The **Federal Reserve** performs the functions of a central bank. It consists of 12 regional banks. The Federal Reserve is independent of the rest of the federal government. The **Board of Governors** has 7 members appointed by the president and confirmed by the Senate. The **Federal Open Market Committee** administers monetary policy.
3. The **tools of monetary policy** are open-market operations, the required reserve ratio, and changes in key interest rates (the **federal funds rate** and the **discount rate**).