

# Econ 2 - Lecture 8 - 4/23/25

Midterm Exam next class, Monday, April 28<sup>th</sup>!

30 Multiple Choice Questions

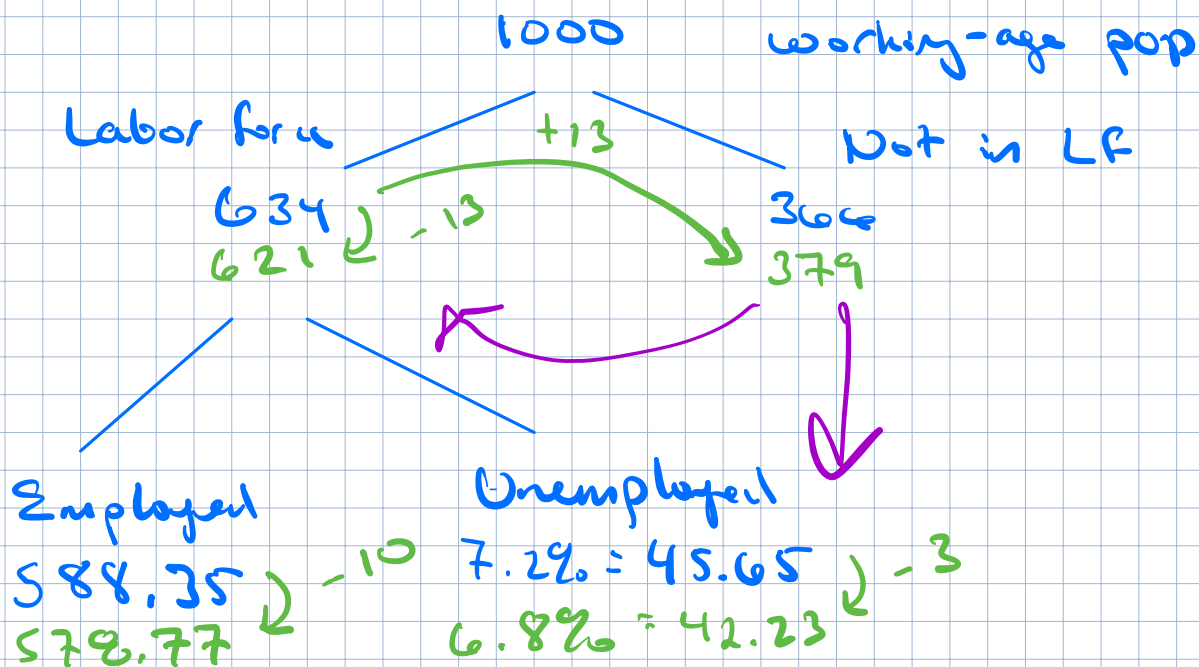
Bring calculator & pencil/pen

Lecture Quiz 4 Released today, due Monday at 12:30<sup>PM</sup>

Weekly Review Session, Thursday, 5:36<sup>PM</sup>, NH 1110

Quick Review Upcoming in 5 minute

## Employment Situation



During recession → lose 13 individuals from LF  
↓  
Discouraged  
Decrease # of employed

# Tracking Inventory Changes

Year 1: 10K units produced  $\rightarrow$  GDP  $\uparrow$  by 10K

8K sold  $\rightarrow$  Cons.  $\uparrow$  by 8K

2K units unsold / stockroom

$\rightarrow$  Change in Private Inventory

Year 2: Inventory Sold  $\leftarrow$

$\uparrow$  in  $I$  of 2K

GDP  $\uparrow$  by 12K  $\leftarrow$  12K units produced

Cons  $\uparrow$  by 10K  $\leftarrow$  10K sold

Remaining  $\rightarrow$  2K units extra

$\rightarrow$  inventory = 2K

Total GDP increase is 10K + 12K = 22K

Goal: Explain why the level of GDP ( $Y$ ) is a particular amount

Why is GDP = 29.7 T (Nominal), 23.5 T (Real)?

Bigger Goal: Full-Employment Level of  $Y = \bar{Y}$

$\rightarrow$  0% cyclical unemployment

Prior to 1900s  $\rightarrow$  uncomplicated growth

Classical Economists: "Laissez-faire", let it be

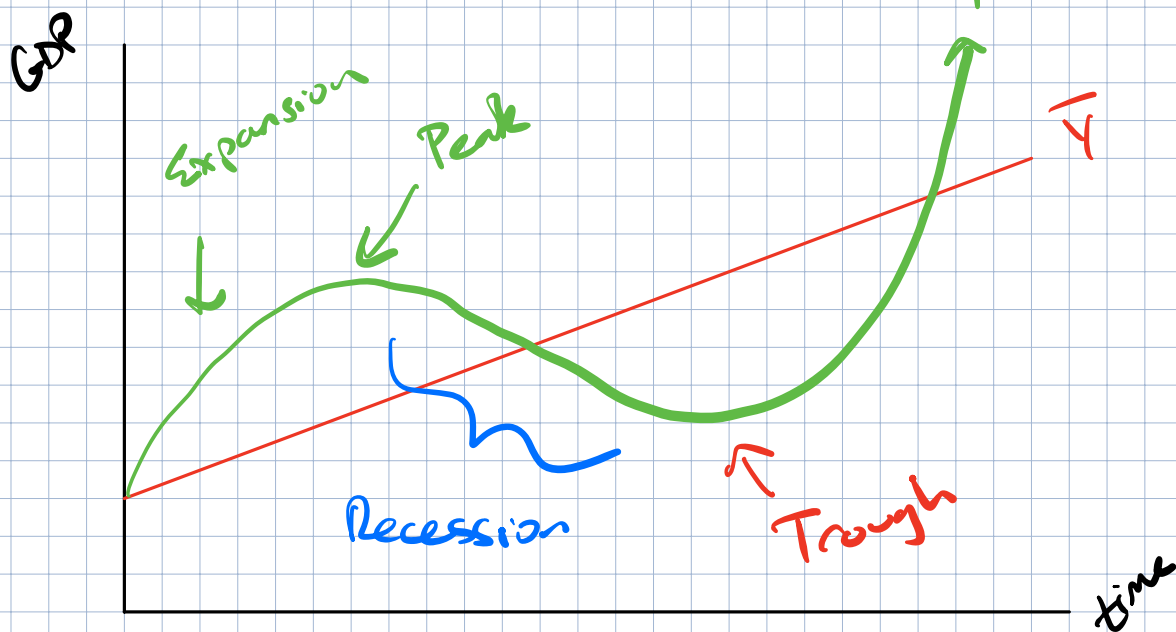
$\rightarrow$  Time will fix any problem  $\rightarrow$  let it be

Great Depression: ~15 years recovery from stock market crash

John Maynard Keynes: "In the long-run, we're all dead."

$\rightarrow$  Policy intervention?

# Follow Business Cycle



Natural Tendency of  $Y$  is to move towards  $\bar{Y}$

Expansion  $\rightarrow$  Peak  $\rightarrow$  Recession  $\rightarrow$  Trough

Recession: Multiple quarters of decreased economic activity

Generally, two consecutive quarters of decreasing  $Y$   
 $\hookrightarrow$  Not in 2022, no increase in unemployment  
 $\hookrightarrow$  Real GDP  $\downarrow$ , Nominal GDP  $\uparrow$

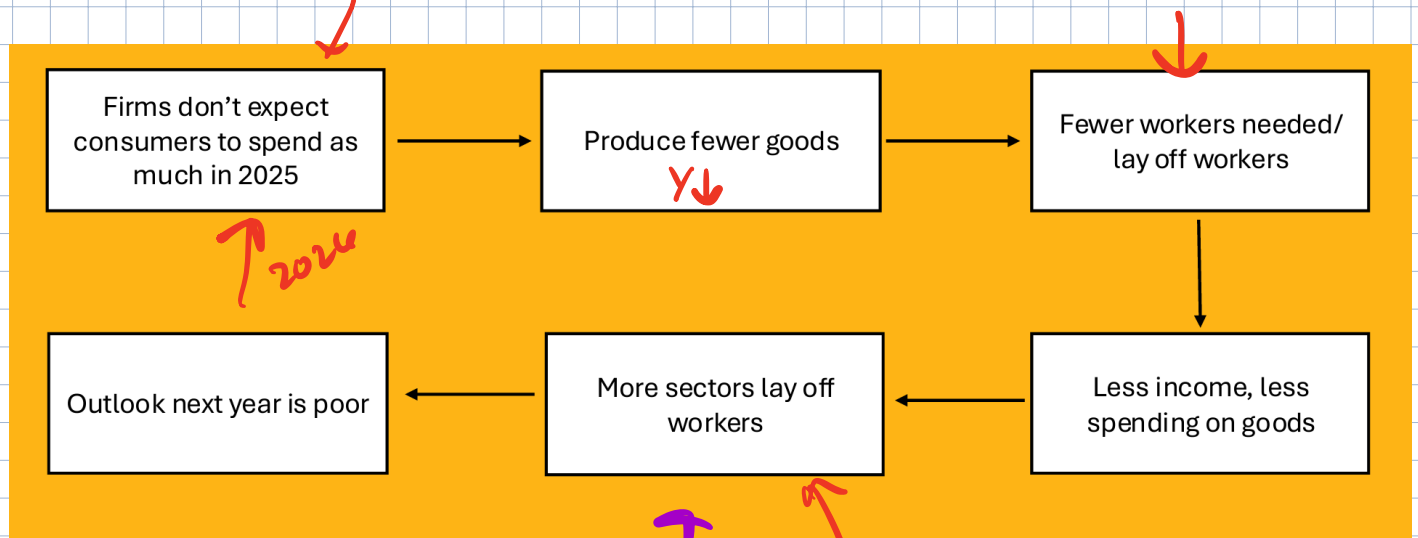
Avg. Recession since WW II  $\approx \sim 10$  months

2007 - 2009: Great Financial Crisis  $\Rightarrow$  18 months  
Great Recession

Depression:  $\sim 10\%$  decrease in GDP, 3-4 yrs long

# Set up framework to understand macroeconomy

cyclical UE



Households  
are concerned  
about future  
→ spend less

## Connection between spending, production, and income

$\begin{matrix} \$100 \text{ guitars} \\ \$90 \text{ rum} \\ \$80 \text{ toys} \end{matrix} \left. \vphantom{\begin{matrix} \$100 \text{ guitars} \\ \$90 \text{ rum} \\ \$80 \text{ toys} \end{matrix}} \right\} \begin{matrix} \text{income generated from spending} \\ = \$270 \\ \text{production value} = \$270 \end{matrix}$

More spending leads to more income

More income  $\Rightarrow$  more production

If spending =  $\phi$

Production =  $\phi$

## Guiding Economic Principle

$$\text{Spending} = \text{Output} = \text{Income} = \text{Production}$$

Need to derive  
what spending is

$$\text{GDP} = Y \text{ (Chapter 3.1)}$$

\* When spending = GDP ( $Y$ )  $\Rightarrow$  Equilibrium

Define spending in the entire economy = Aggregate Expenditures (AE)

Equilibrium when  $Y = AE$

$$Y = \text{GDP} = C + I + G + NX$$

What does AE contain? Groups of spenders

Households, Firms, Government, Foreign Investors

~70% of spending

15-20% of  
spending

Households drive spending, Aggregate Expenditures (AE)

Household Spending = Consumption ( $C$ )  $\rightarrow$  Same as GDP  
 $\Rightarrow C + I + G + NX$

What is determining how much a household spends?