Fall 2009

14.02 Principles of Macroeconomics

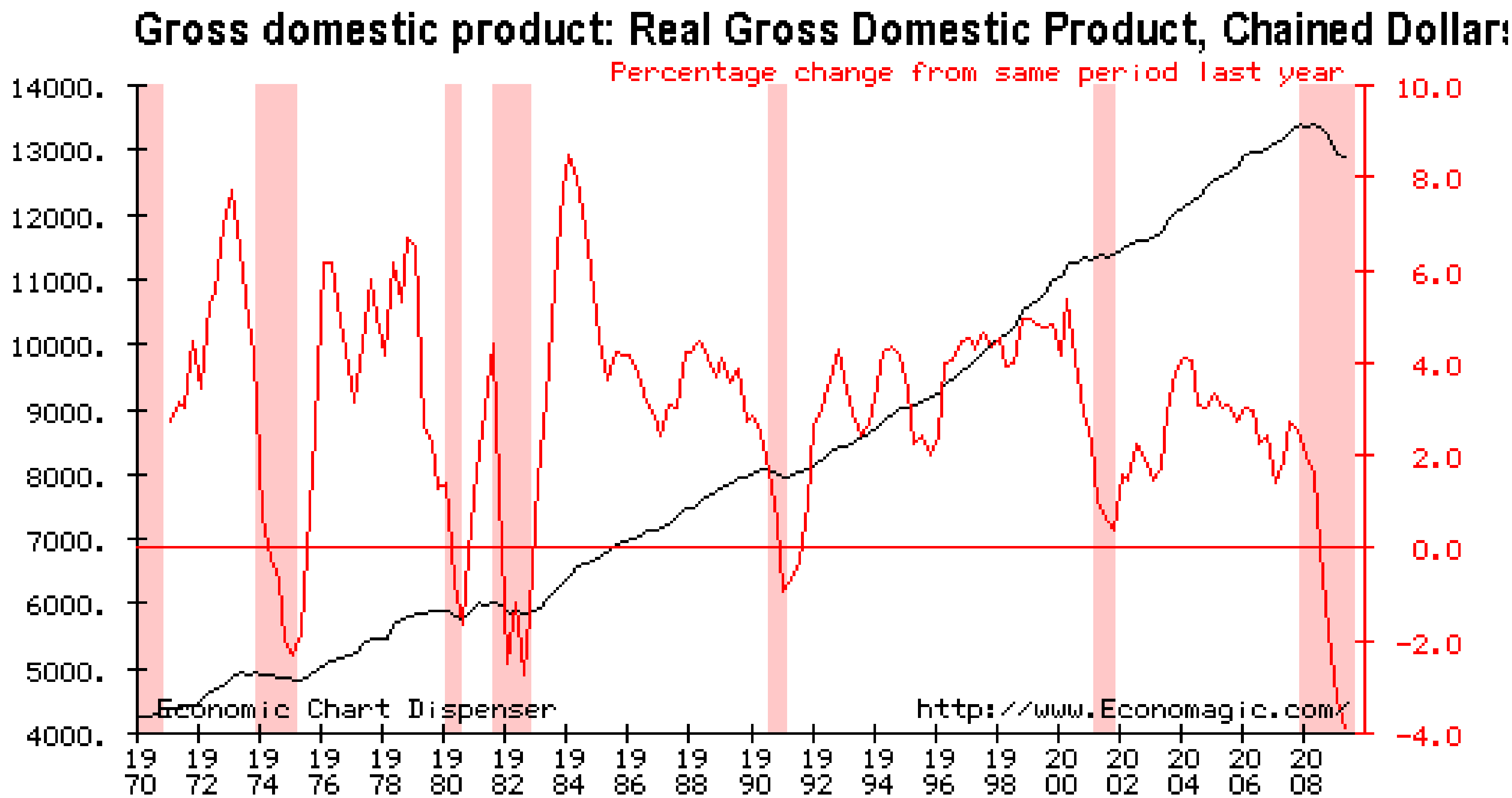
Veronica Guerrieri

What Macroeconomics is about?

Macroeconomics studies the structure of aggregate economies and the impact of policies on their performance.

- What determines economic fluctuations? (business cycle)
- Why some countries grow faster than others ? (economic growth)
- What causes unemployment ?
- What drives prices changes? (inflation)
- What is the role of economic policies and the government? (monetary and fiscal policies)
- How being part of a global economic system affects the economy of a country?

Historical Real GDP: 1970Q1 – 2009Q2



Black line - trend in real GDP over time (black axis)

Red line - trend in real GDP *growth* (percentage change in real GDP) over time (right axis)

Shaded areas represent “official” recession dates (as calculated by National Bureau of Economic Research)

What is a Recession?

- "Official Rule of Thumb" - 2 or more quarters of *negative* *real* *GDP* *growth*
  NOT NECESSARY THE CASE!

- Most Economies are usually ***not*** in recession

  – U.S. average postwar expansion: 50 months

  – U.S. average postwar recession: 11 months

  – The 1990s experienced the longest expansion since 1850 (the second longest was 106 months ; 1961-1969)

- **Great Moderation:** after the mid-'80s, expansions have become more stable and recessions less frequent and less severe

- What about the **current recession**? Is the Great Moderation ended?

  – For Information on Business Cycle Dates see: http://www.nber.org/cycles.html

More on Recession Dates

Dates		*Length*
2/61 - 11/69	Expansion	106 montbs
12/69 - 10/70	Recessions	11 months
11/70 - 10/73	Expansion	36 months
11/73 - 2/75	Recession	16 months
3/75 - 12/79	Expansion	58 months
1/80 - 6/80	Recession	6 months
7/80 - 6/81	Expansion	12 months
7/81 - 10/82	Recession	16 months
11/82 - 6/90	Expansion	92 months
7/90 - 2/91	Recession	8 months
3/91 - 3/01	Expansion	121 months
4/01 - 12/01	Recession	8 months
1/02 - 12/07	Expansion	73 months
12/07 – now	Recession	12 months

More on Recession Dates

Dates		*Length*
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3/75 - 12/79	Expansion	58 months
1/80 - 6/80	Recession	6 months
7/80 - 6/81	Expansion	12 months
7/81 - 10/82	Recession	16 months

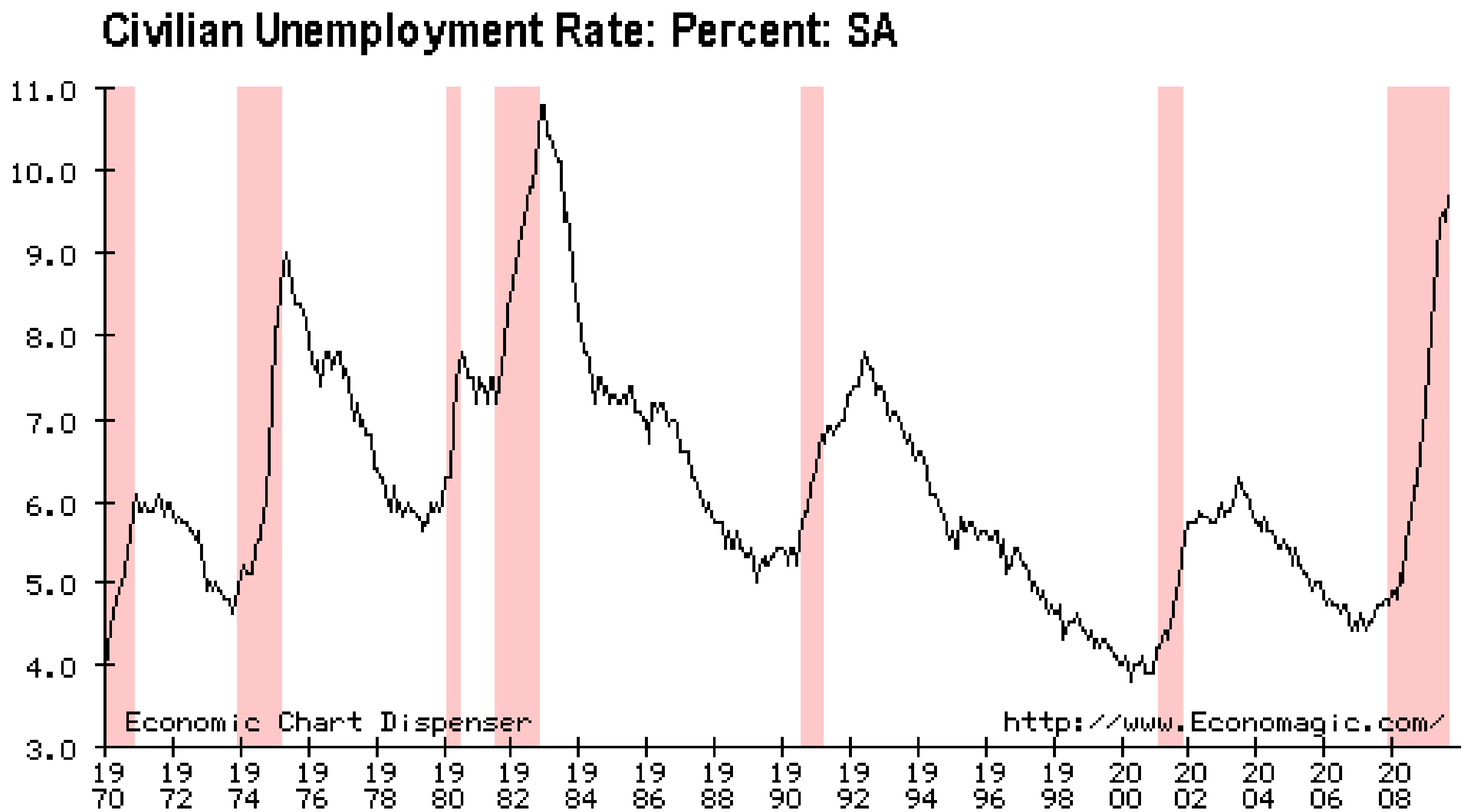
49 months of recession in 21 years

The Great Moderation

11/82 - 6/90	Expansion	92 months
7/90 - 2/91	Recession	8 months
3/91 - 3/01	Expansion	121 months
4/01 - 12/01	Recession	8 months
1/02 - 12/07	Expansion	73 months
12/07 – now	Recession	20 months

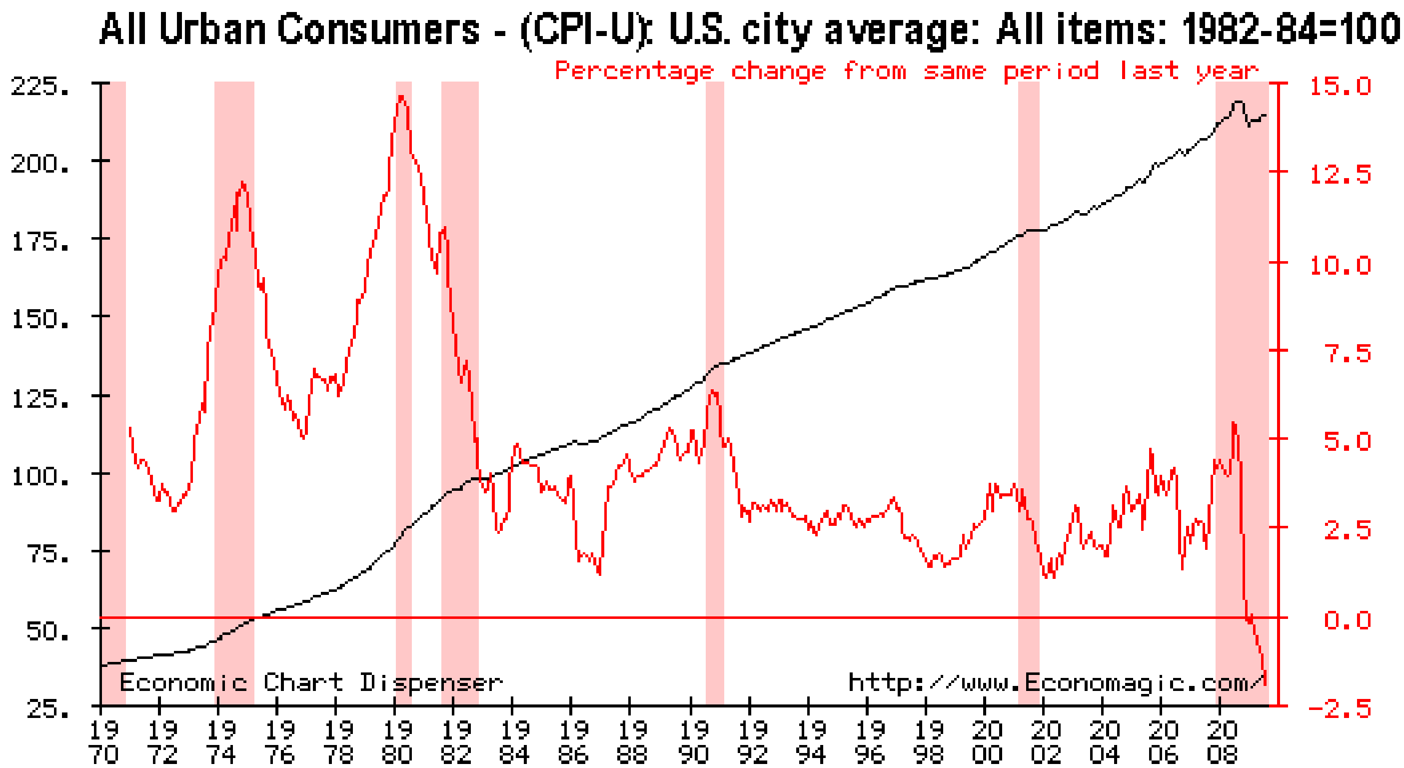
16 months of recession in 24 years

Historical Unemployment: 1970M1 – 2009M8



Shaded Areas – "Official" Recession Years

Historical Inflation: 1970M1 - 2009M7



Black line - trend in CPI over time (left axis)

Red line - trend in CPI inflation rate (percentage change in CPI) over time (right axis)

Shaded areas represent “official” recession dates (as calculated by National Bureau of Economic Research)

Thoughts on the Current U.S. Economic Outlook

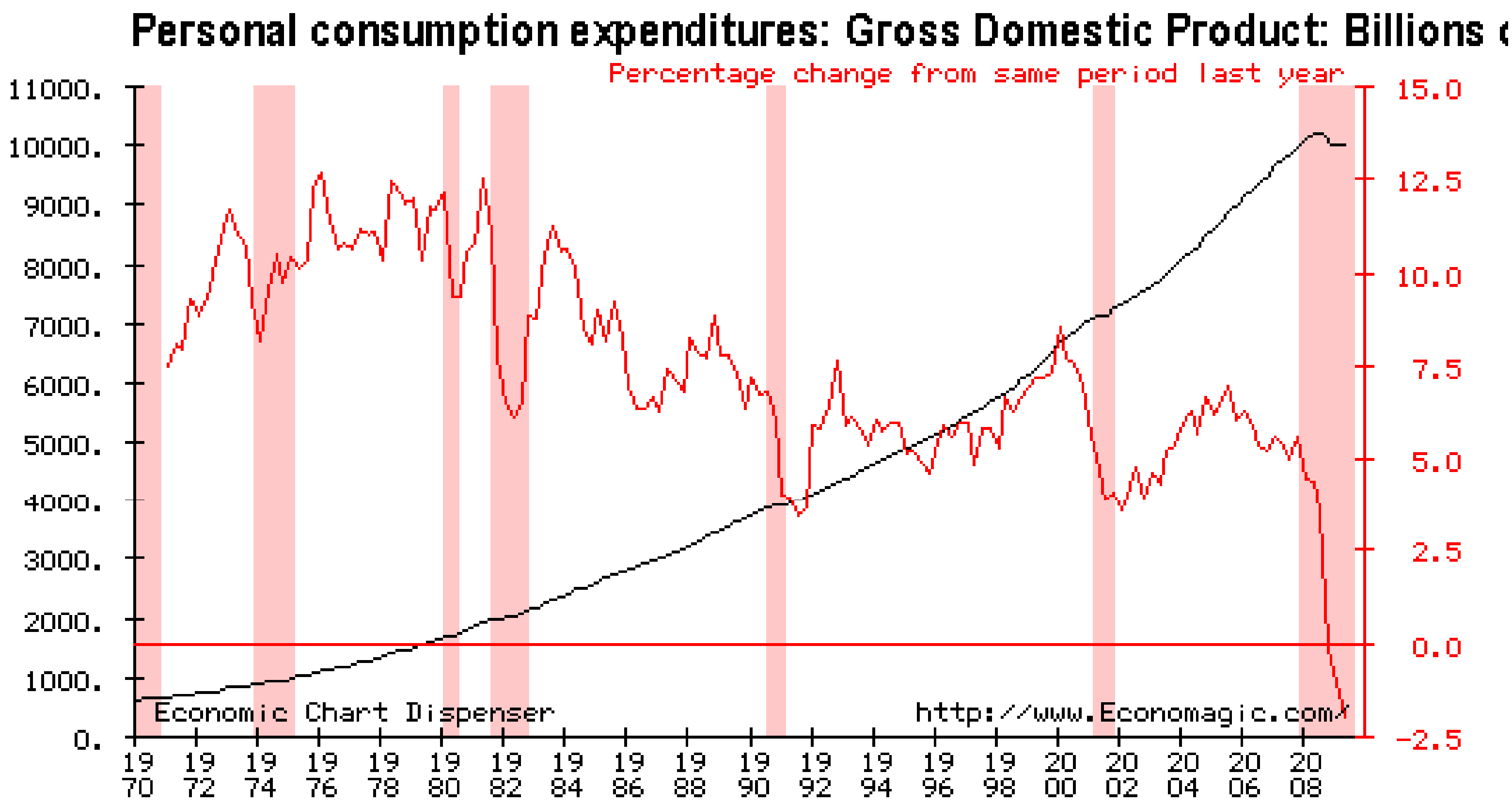
- Business Cycle, Economic Growth, Unemployment Rate, Inflation

- **Spending of Economic Agents (Consumers and firms spend when they are optimistic about the future).**

  - **Consumers** (~ **70%** of the U.S. economy)
  - **Business** (~ **15%** of the U.S. economy)

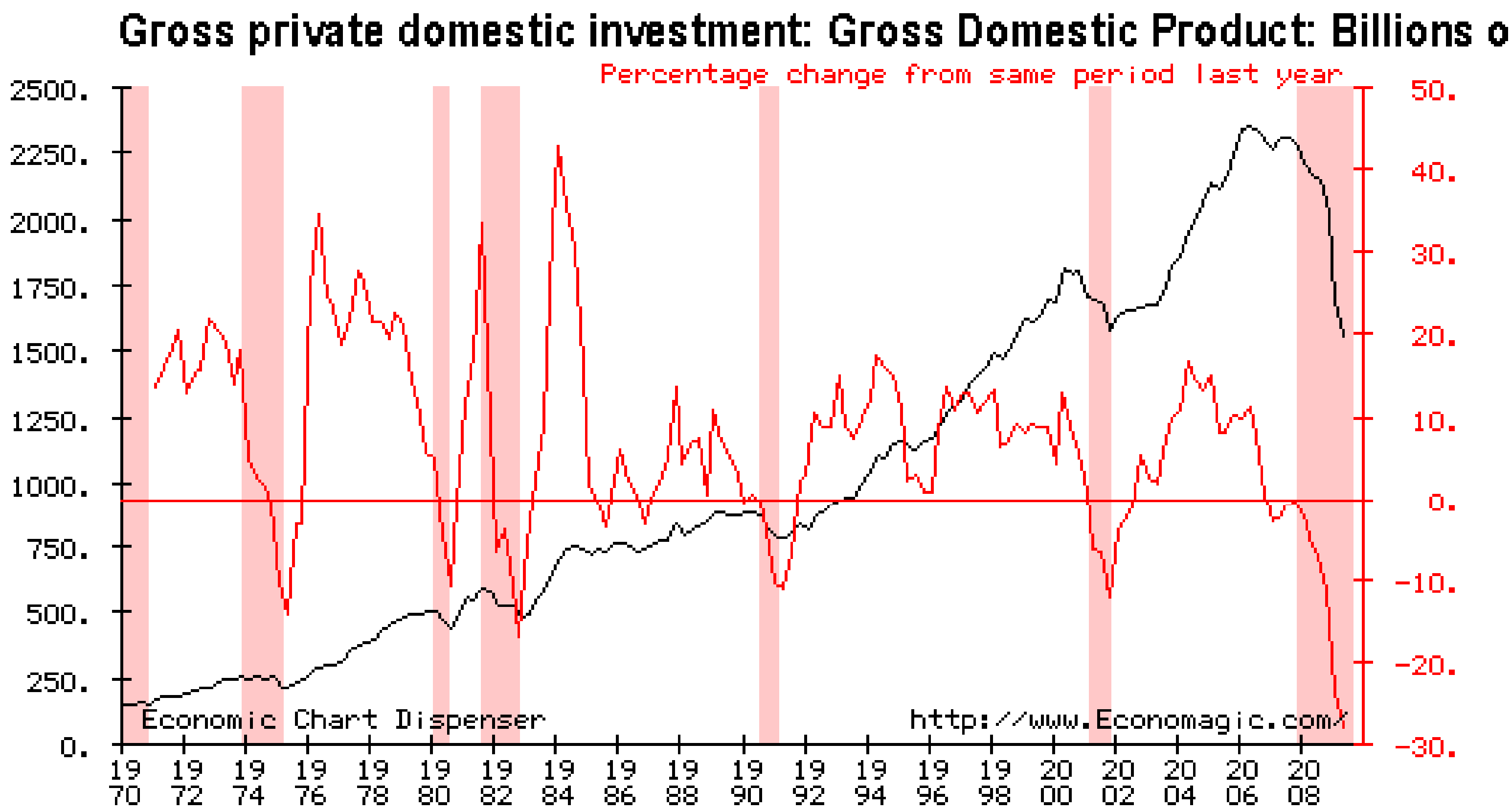
  - **Governments** (~ **20%** of the U.S. economy)
  - **Foreign Sector** (~ **-5%** of the U.S. economy)

Real Household Spending: 1970Q1 – 2009Q2 (Consumption)



Black Line – Level of Spending (Left Axis)
Red Line – Percentage Change in Spending over Prior 12 months (Right Axis)
Shaded Areas – Recession Years

Real Business Spending: 1970Q1 – 2009Q2 (Investment)



Black Line – Level of Spending (Left Axis)

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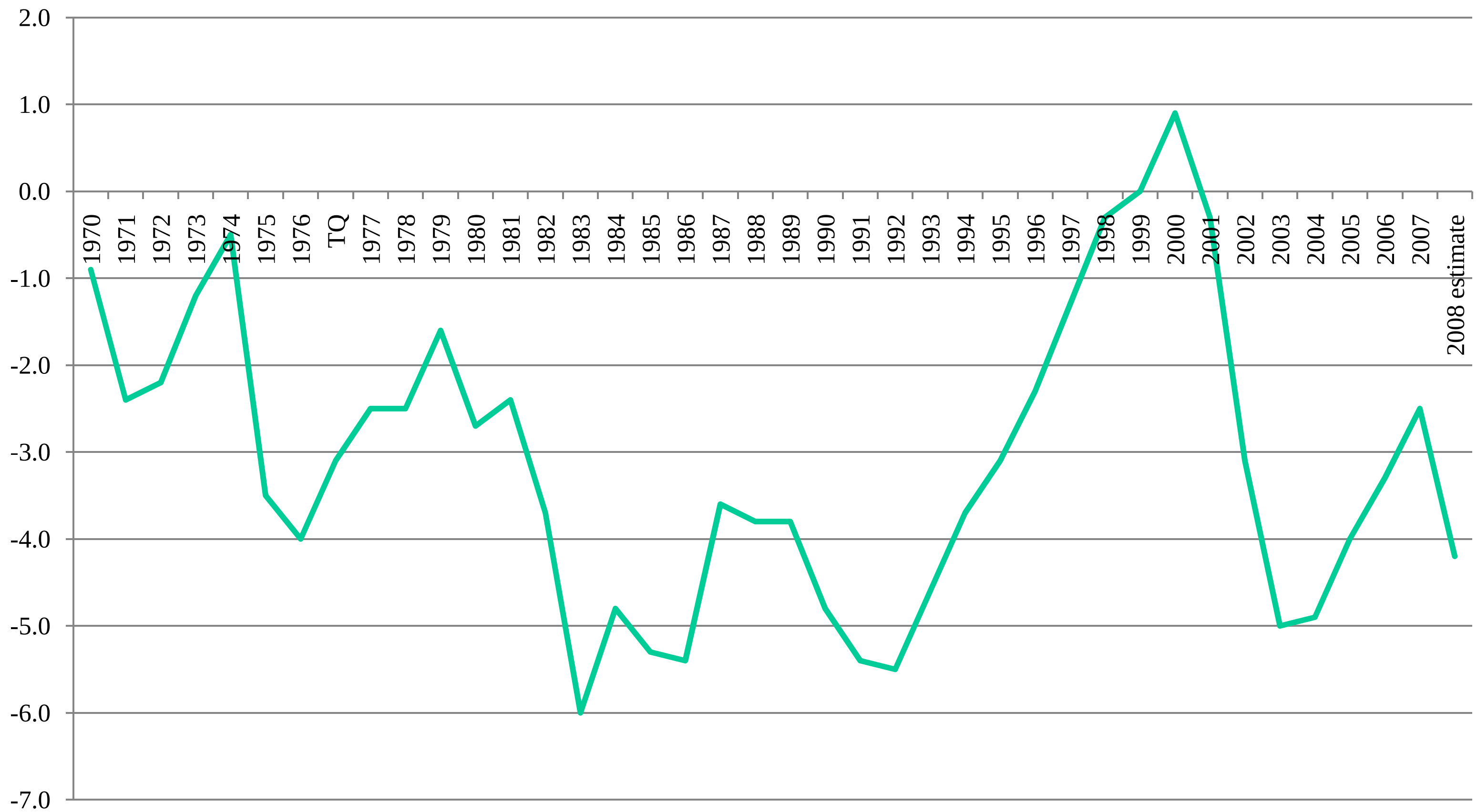
Shaded Areas – Recession Years

Federal Budget Deficit (as share of GDP)



Thoughts on the Current U.S. Economic Outlook

- Business Cycle, Economic Growth, Unemployment Rate, Inflation

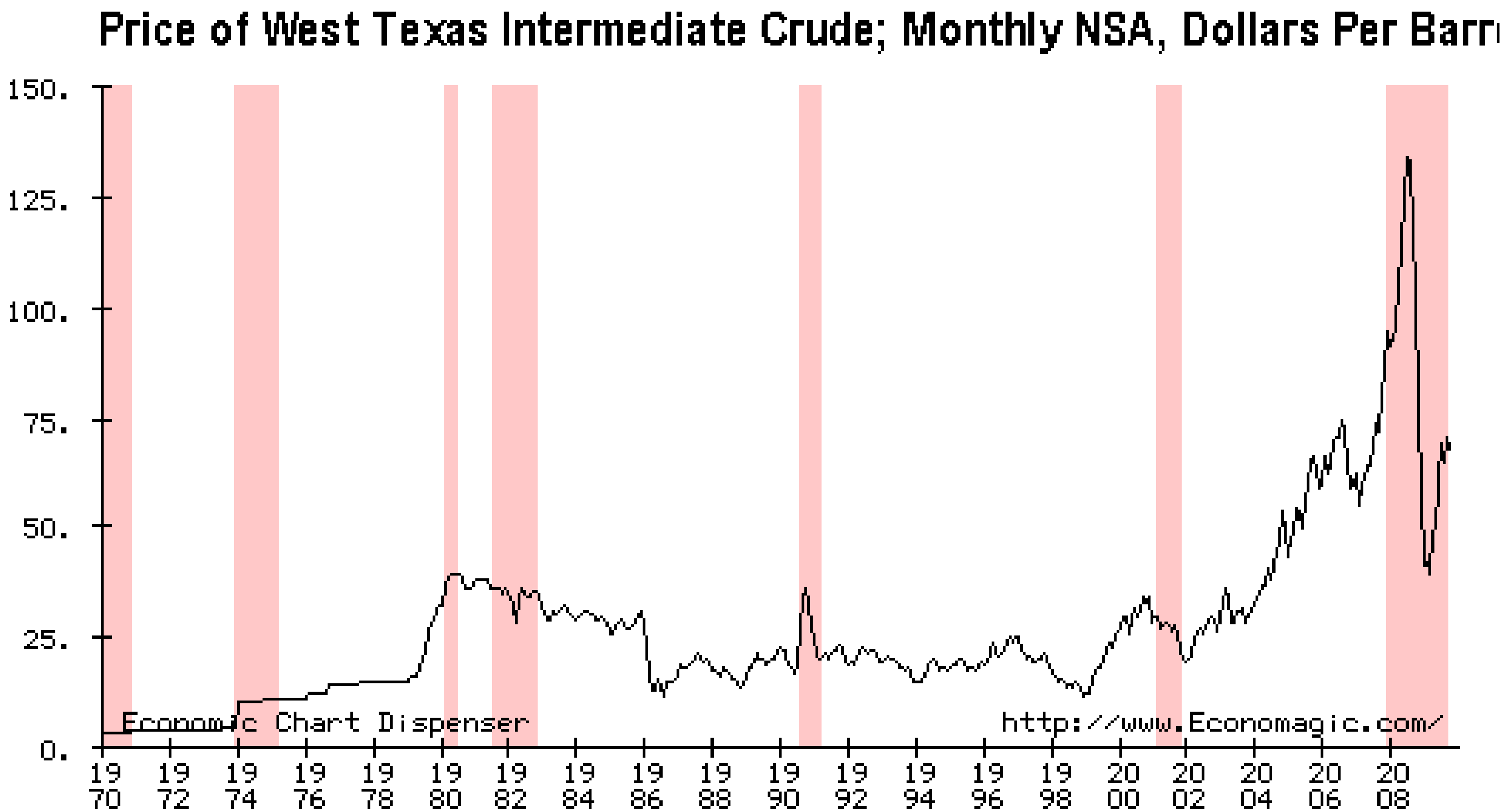
- Spending of Economic Agents

  - Consumers
  - Business
  - Governments
  - Foreign Sector

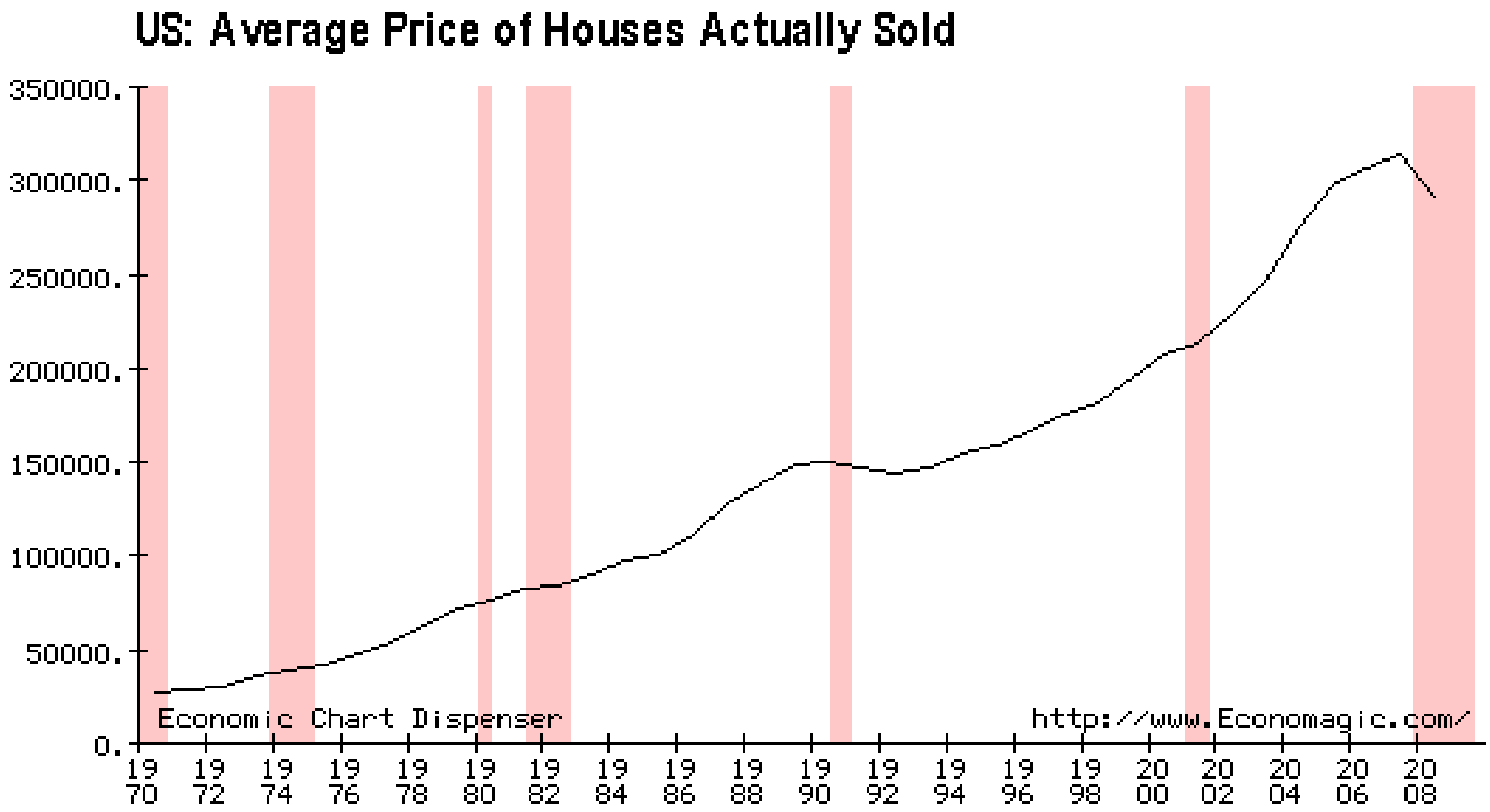
- **Other Things on My Mind**

  - **Oil Prices**
  - **Technology Growth**
  - **Current Account Deficits**
  - **Monetary Policy (Fed)**
  - **Housing Market**

Nominal Oil Prices (per Barrel): 1970M1 – 2009M8



Housing prices: 1970 – 2008



Questions We Will Address This Term

- How do countries grow over long periods of time? Why do some countries grow faster than others? Why has the U.S. grown so rapidly during the last decade? Why has Japan stagnated during the last two decades? Is the new economy really new?

- Can rising oil prices increase the inflation rate? If so, how? Why do we care about rising inflation rates? What can the Federal Reserve do to mitigate rising inflation rates? Is there a cost to their policy?

- More generally, what is the role of the Federal Reserve in the macroeconomy? How do they influence interest rates? How do interest rates affect unemployment, production, etc.? How Bernanke's regime is different from Greenspan's? Should the Fed follow explicit policy rules (i.e., target a 2% inflation rate – always) or should they follow some discretion? What is a liquidity trap?

Questions We Will Address This Term

- Does the President/Congress have significant impact on the economy in the short run? Can they affect the econom y in the long run? Can large budget deficits hinder economic growth in the long run?

- Should macro economists care about trade deficits? Why could large trade deficits be a good thing for an economy?

- What are the role of labor markets in the economy? What is a “job less” recovery? Is this a new phenomenon?

- What has caused the current recession? What has been the role of the housing slump? How the Government and the Fed has reacted? How the recession has affected the US economy and the rest of the world?

Course Preliminaries

• Class Format:	2 options (choose by September 25th): 1. Lectures by Prof. Guerrieri + Recitiation by TA 2. All sections by TA
• Quizzes:	Quiz #1: Thursday, October 8th, 7:30-9:00 PM Quiz #2: Thursday, November 5th, 7:30-9:00 PM Quiz #3: Thursday, December 3rd, 7:30-9:00 PM
• Problem Sets:	there will be 6 problem sets
• Grading Policy:	90% quizzes (average of the highest 2 grades) 10% problem sets (average of the highest 5 grades)
• Material:	Required Book and Lecture notes

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