

Macroeconomics vs. Microeconomics

Macroeconomics (*Income and Employment Theory*)

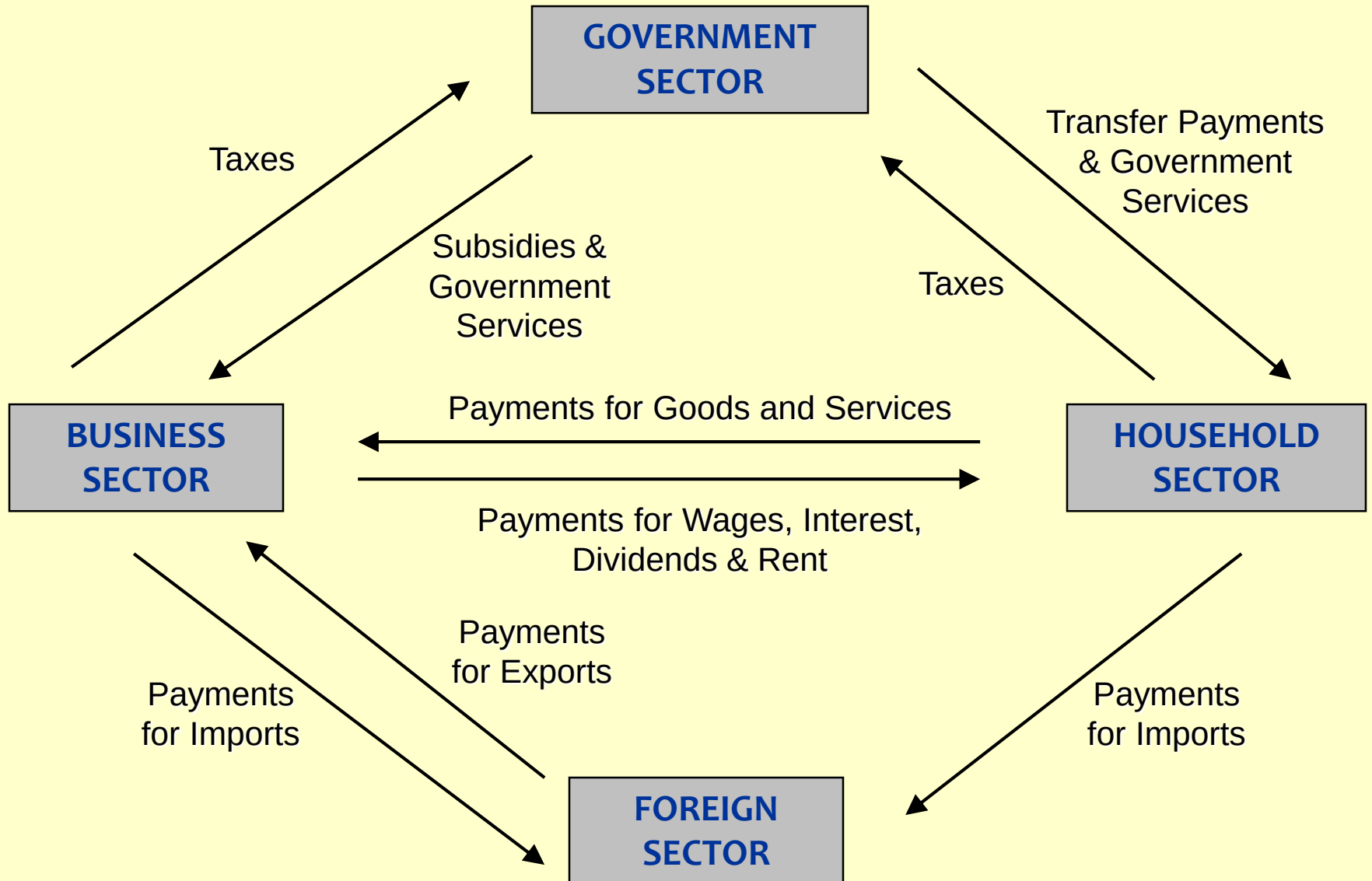
- Studies the behaviour of aggregate (total) economic variables such as income, employment, price level etc...

Microeconomics (*Price Theory*)

- Studies the behaviour of individuals and groups of individuals, such as consumers, households and businesses.

The Circular Flow Model

- traces the exchange of goods and services in the economy
- use of money in the economy results in a two-way circular flow - of goods and services in one direction and money in the other direction - between:
 - > *Consumers (Households)*
 - > *Businesses (Firms)*
 - > *Government*
 - > *Other Countries*



Mixed Market Economy Sectors

Consumption (C)

- spending by households on consumer goods and services including:
 - > non-durable goods eg. food
 - > durable goods eg. cars, appliances
- primarily affected by consumer's *disposable income* (income remaining after taxes)



What percentage of total spending within the economy is generated by households?

Approximately 60%, meaning 60 cents out of every dollar spent comes from consumers

Gross Investment (I)

- creation of a new business or expansion of an existing one or the improvement in the production capability of a business through:
 - *a new factory, new equipment, better technology, worker retraining, new management techniques etc...*
- gross investment also includes:
 - changes in inventories (*stocks of unsold goods and materials*)
 - construction of all buildings, such as houses and apartments
 - expenditures by government agencies on equipment and machines
- decision to invest affected by *expectations of profit and interest rates (borrowing costs)*



Government (G)

- government purchases include current spending by all levels of government on goods and services
 - *federal government purchase of battleship for armed forces*
 - *municipality contracts a company to repave a stretch of road*
- government spending affected by tax revenues and spending priorities
 - i.e. budget condition (deficit/debt) / health care vs. defence*



Foreign Sector (X - M)

- **exports include purchases of Canadian goods and services by foreigners**
 - *British flour mill buys Canadian wheat*
 - *Foreign tourist spends a week in a Canadian hotel*
- payments for exports remain in Canadian circular flow of money and thus add to GDP
- **imports include Canadian purchases of foreign goods and services**
 - *Canadian imports of Italian wine*
 - *Canadian tourists spending abroad*
- payments for imports leave the Canadian circular flow of money and are subtracted from GDP
- **Statistics Canada uses Net Exports (X-M) to reconcile spending inside and outside Canada**



Gross Domestic Product (Total Spending)

- adding together (aggregating) the four categories of spending gives us the GDP expenditure equation:

$$\text{GDP} = C + I + G + (X - M)$$

Excluded Items from GDP

- Financial exchanges
 - > *gifts of money between friends & family; bank deposits or stocks purchases*
- Second Hand Purchases
 - > *purchases of second-hand or used goods*



Macroeconomics IQ Quiz



1. Which sector of the economy is the *most* stable during a typical business cycle? the *least*?
2. Why is savings spending?
3. If the federal government built new Canada Post offices, under what expenditure component would this be classified?
4. What part of the GDP expenditure equation would we need to examine to determine if a country had a trade deficit?
5. If GDP can be determined by adding the total expenditures generated by the four economic sectors, is there another way to calculate GDP?