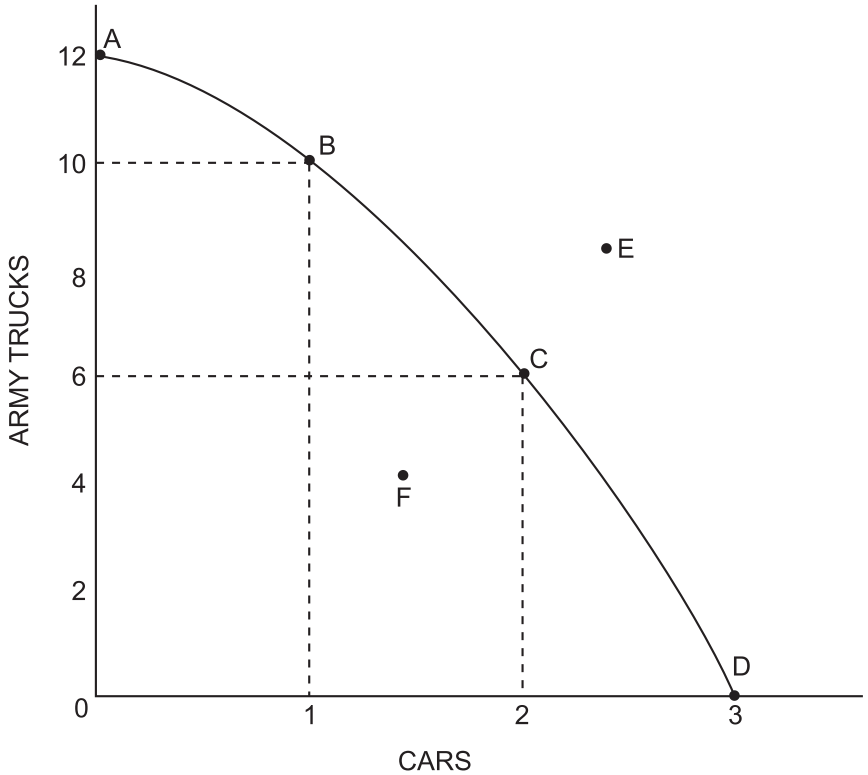
The Economic Way of Thinking

- Everything has a cost.
- People choose for good reasons.
- People gain from voluntary trade.
- Economic thinking is marginal thinking.
- The value of a good or service is affected by people's choices.
- Economic actions create secondary effects.
- The test of a theory is its ability to predict correctly.

Production Possibilities Curve



(1) **What trade-offs are involved?**

(2) **Why is the PPC concave, or bowed out, from the origin?**

(3) **What does a point inside the PPC illustrate?**

(4) **What is a historical example of a point inside the PPC?**

(5) **What is the significance of a point outside the PPC?**

(6) **Under what conditions can a point outside the PPC be reached?**

(7) **What would a country's PPC look like if it did not have a scarcity of resources?**

Determining Comparative Advantage (Output Method)

	Output per hour	
	CDs	Pounds of beef
Japan	20	5
Mexico	30	15

(1) Which country has an absolute advantage in producing CDs?

(2) Which country has an absolute advantage in producing beef?

(3) Which country has a comparative advantage in producing CDs?

(4) Which country has a comparative advantage in producing beef?

(5) Which country should specialize in CD production?

(6) Which country should specialize in beef production?

Determining Comparative Advantage (Input Method)

	Time required for one unit	
	1 CD	1 pound of beef
Japan	3 minutes	12 minutes
Mexico	2 minutes	4 minutes

(1) Which country has an absolute advantage in producing CDs?

(2) Which country has an absolute advantage in producing beef?

(3) Which country has a comparative advantage in producing CDs?

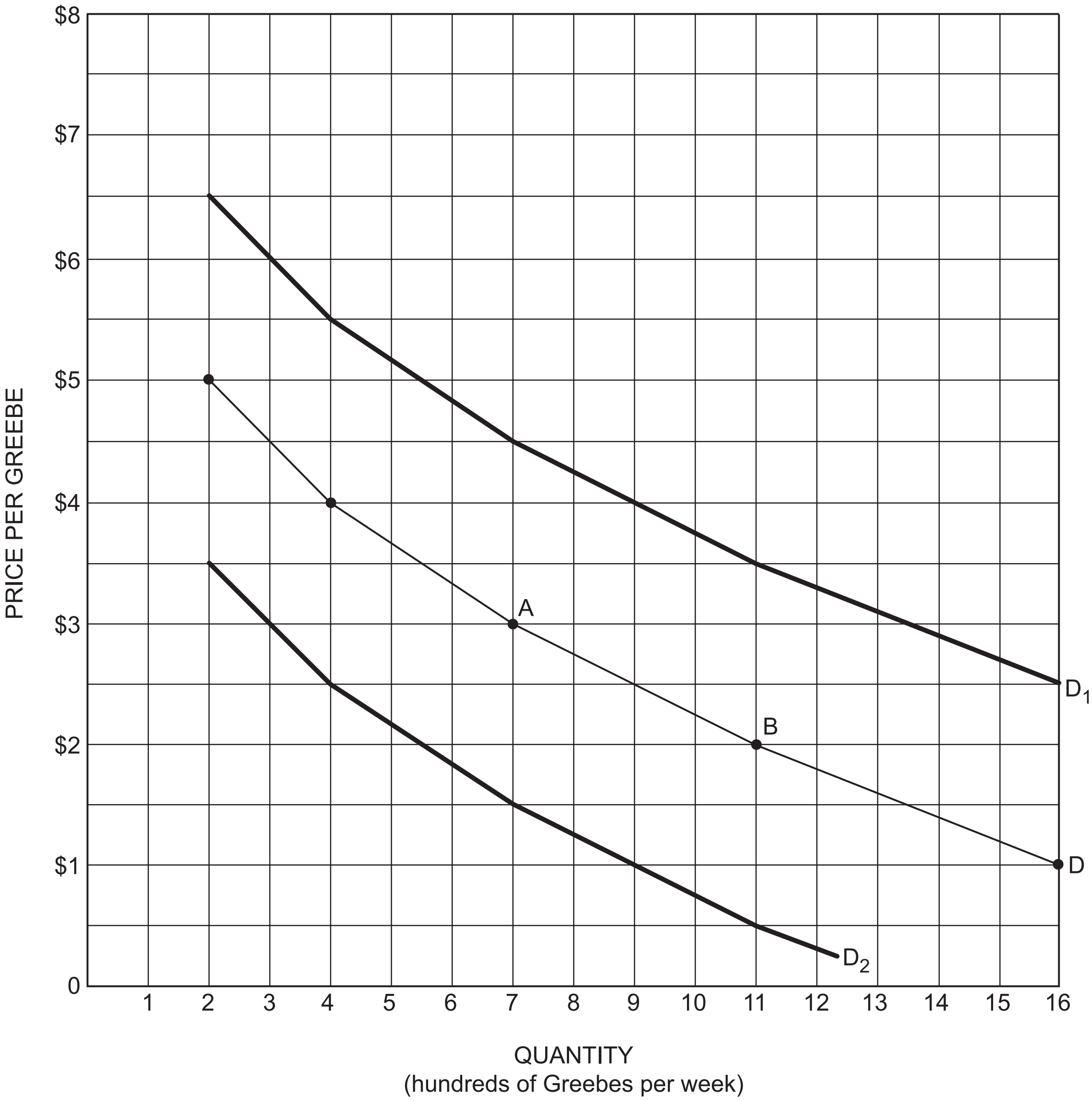
(4) Which country has a comparative advantage in producing beef?

(5) Which country should specialize in CD production?

(6) Which country should specialize in beef production?

CEE-APE_MACROSE-12-0101-MATM-Book.indb 19 28/07/12 12:19 AM

Illustrating the Difference between a Change in Demand and a Change in Quantity Demanded

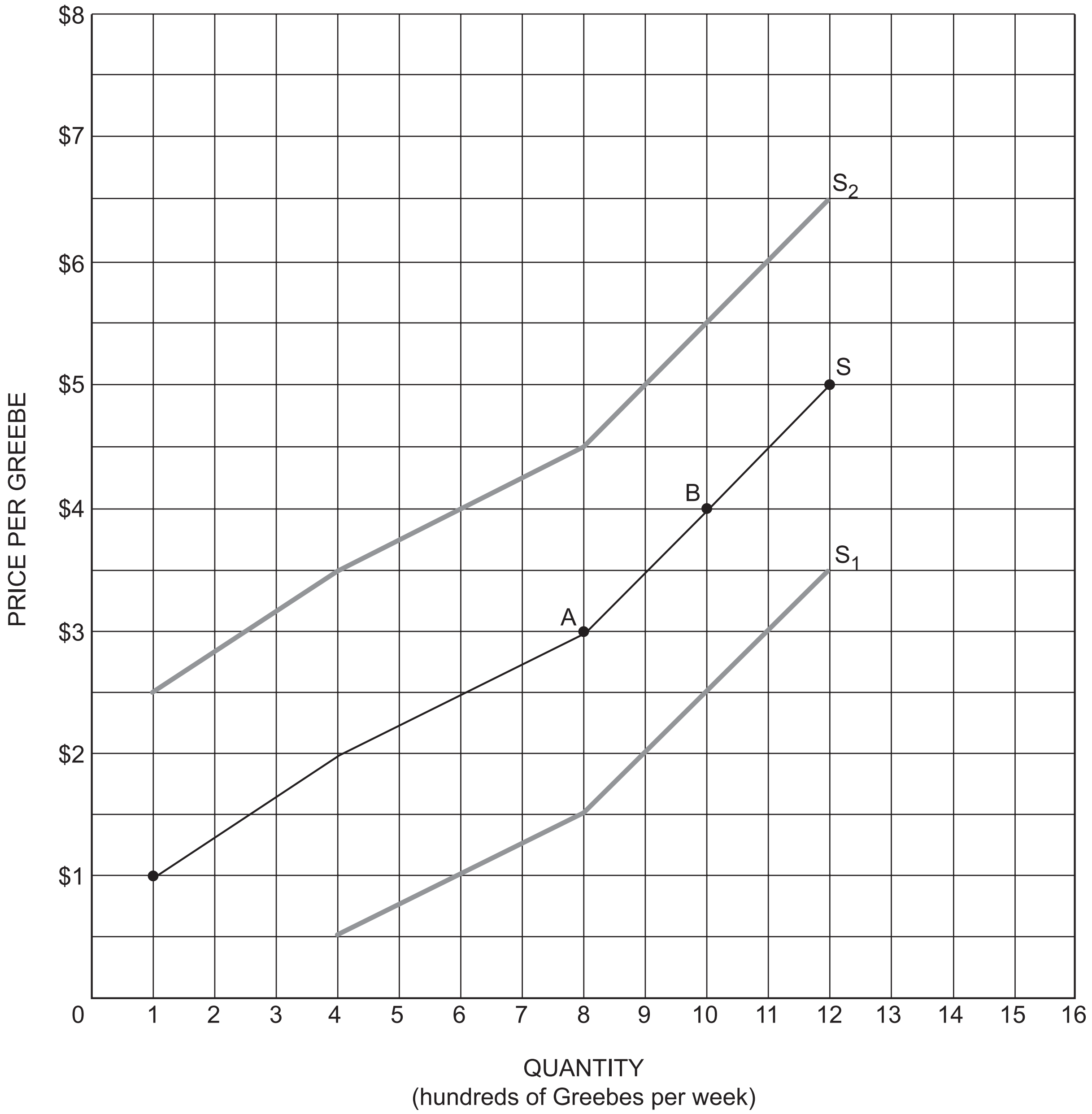


Determinants of Demand

FACTORS THAT SHIFT THE DEMAND CURVE

- Change in consumer tastes
- Change in the number of buyers
- Change in consumer incomes
- Change in the prices of complementary and substitute goods
- Change in consumer expectations

Illustrating the Difference between a Change in Supply and a Change in Quantity Supplied



Determinants of Supply

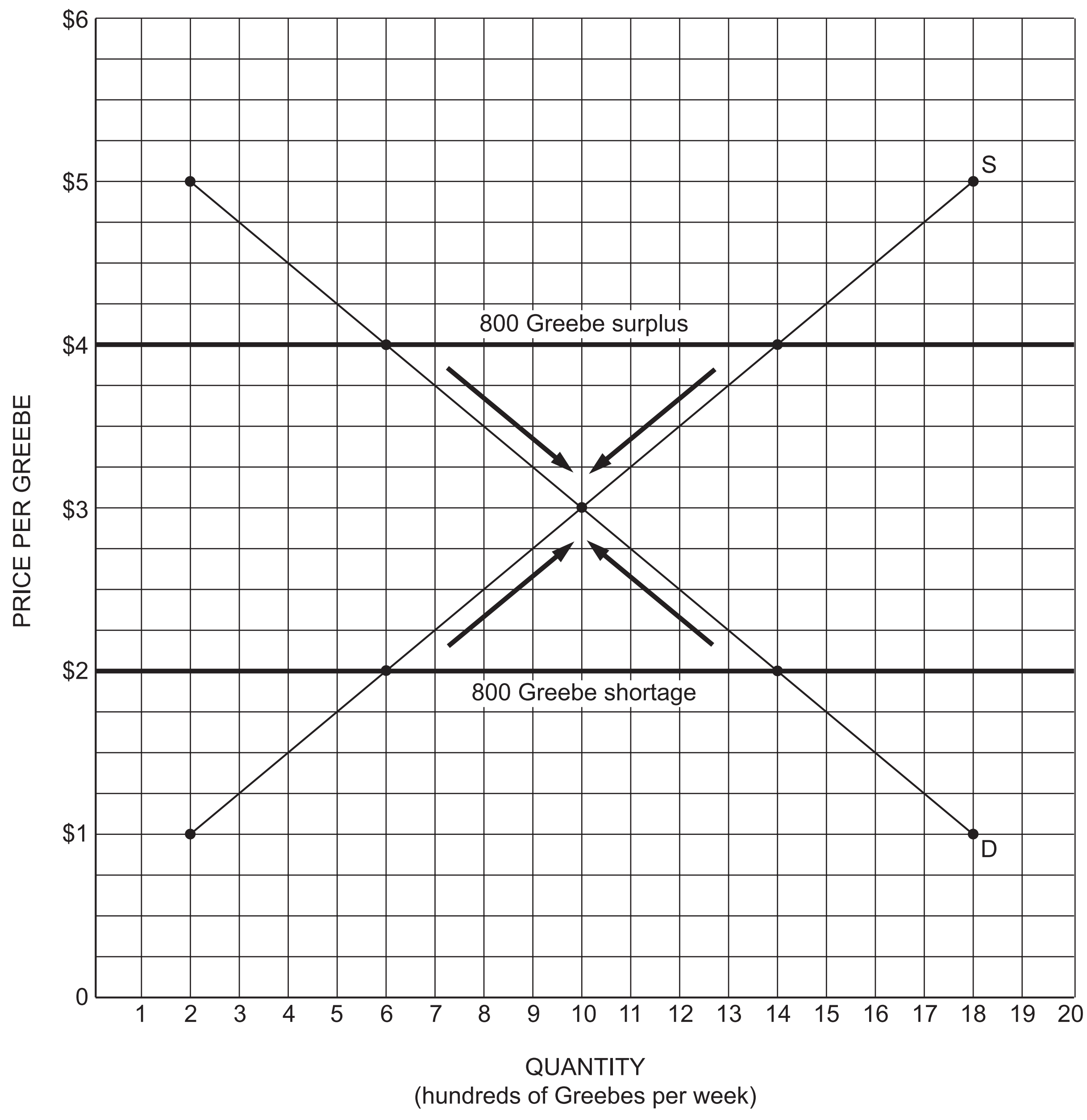
FACTORS THAT SHIFT THE SUPPLY CURVE

- **Change in resource prices or input prices**
- **Change in technology**
- **Change in taxes and subsidies**
- **Change in the prices of other goods**
- **Change in producer expectations**
- **Change in the number of suppliers**

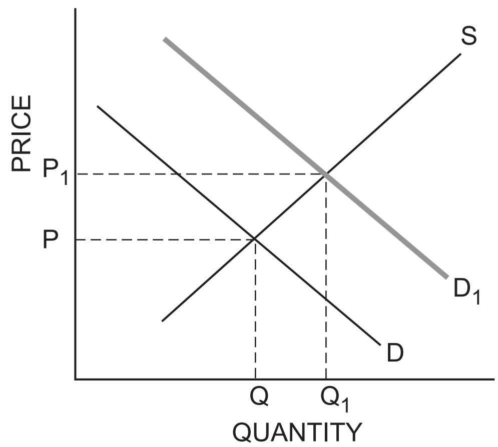
Any factor that *increases* the cost of production *decreases* supply.

Any factor that *decreases* the cost of production *increases* supply.

Equilibrium and Disequilibrium

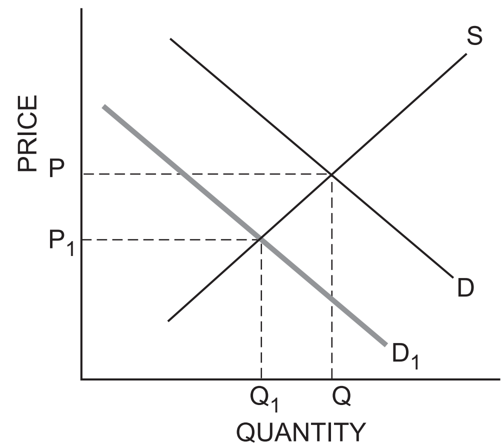


The Effects of Shifts in Demand or Supply



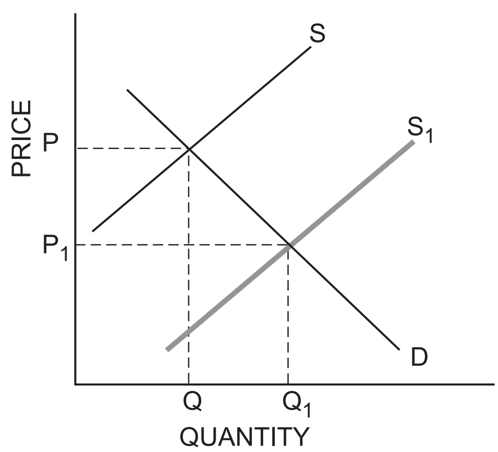
A. INCREASE IN DEMAND

D ↑
P ↑
Q ↑



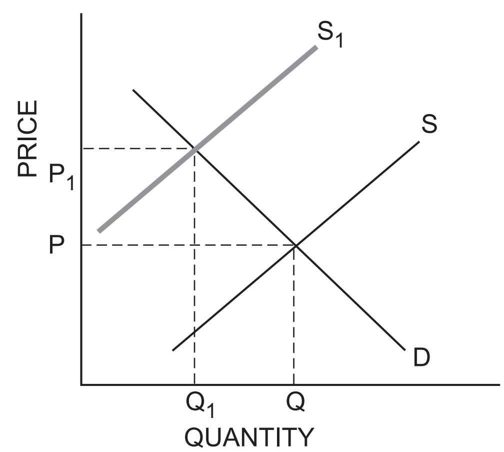
B. DECREASE IN DEMAND

D ↓
P ↓
Q ↓



C. INCREASE IN SUPPLY

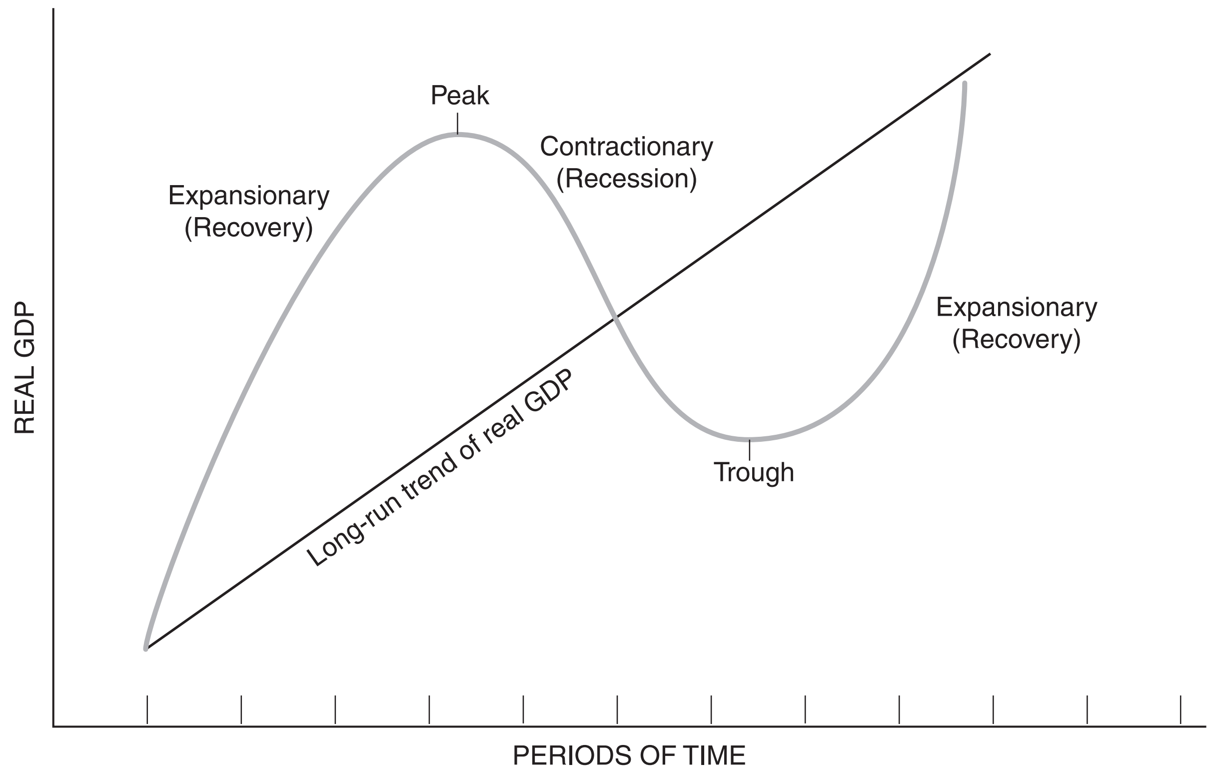
S ↑
P ↓
Q ↑



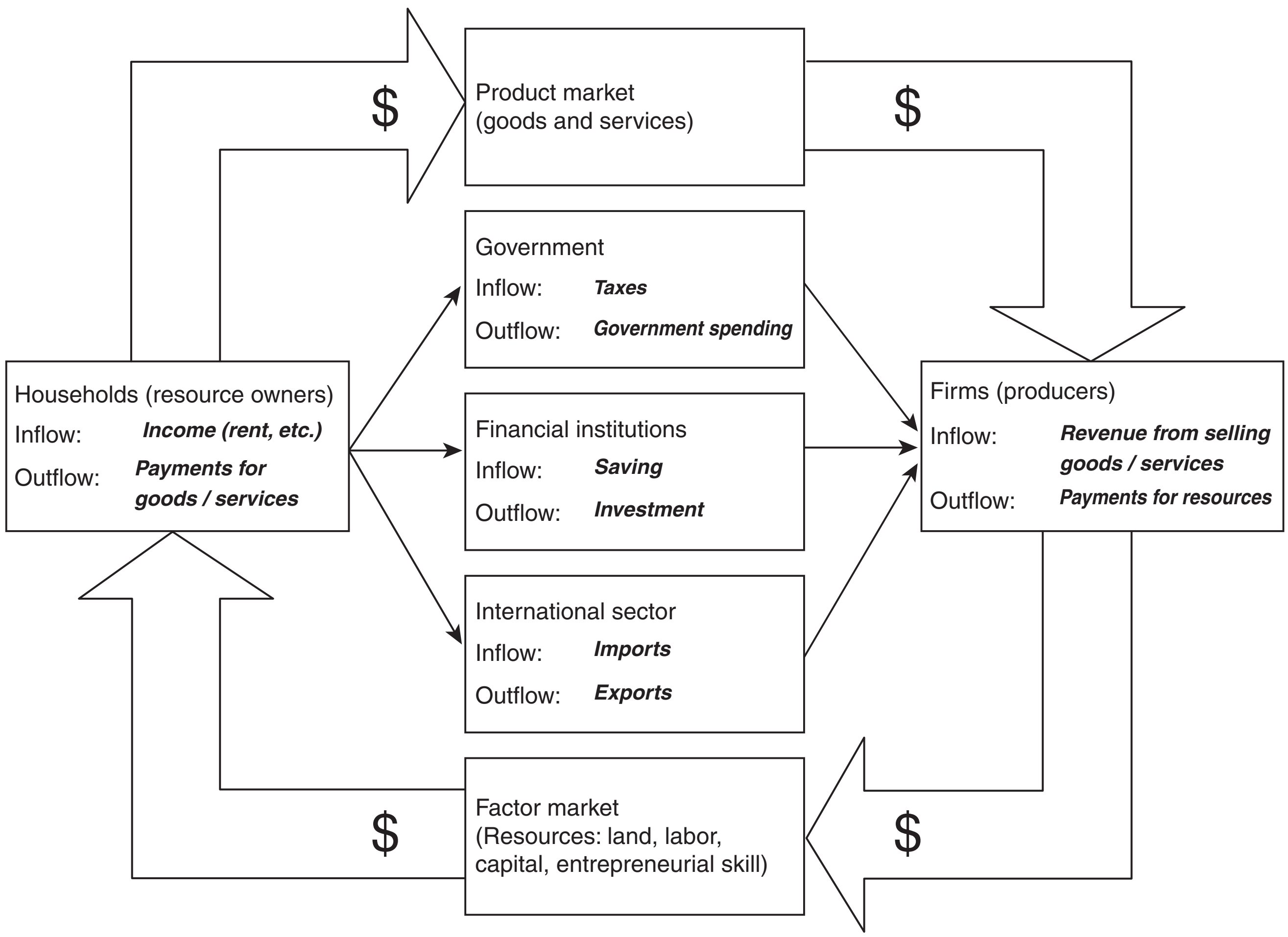
D. DECREASE IN SUPPLY

S ↓
P ↑
Q ↓

Phases of the Business Cycle



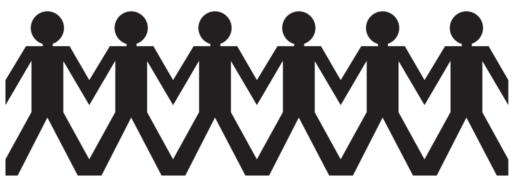
Circular Flow Diagram



In and Out of the Labor Force

POPULATION

IN
the labor force



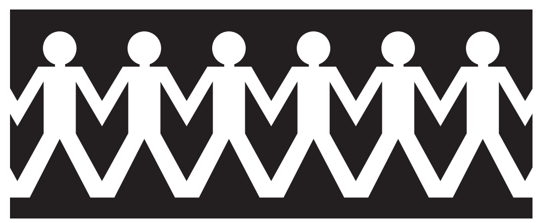
Employed

- Currently holds a full- or part-time job
- Includes those who are underemployed

Unemployed

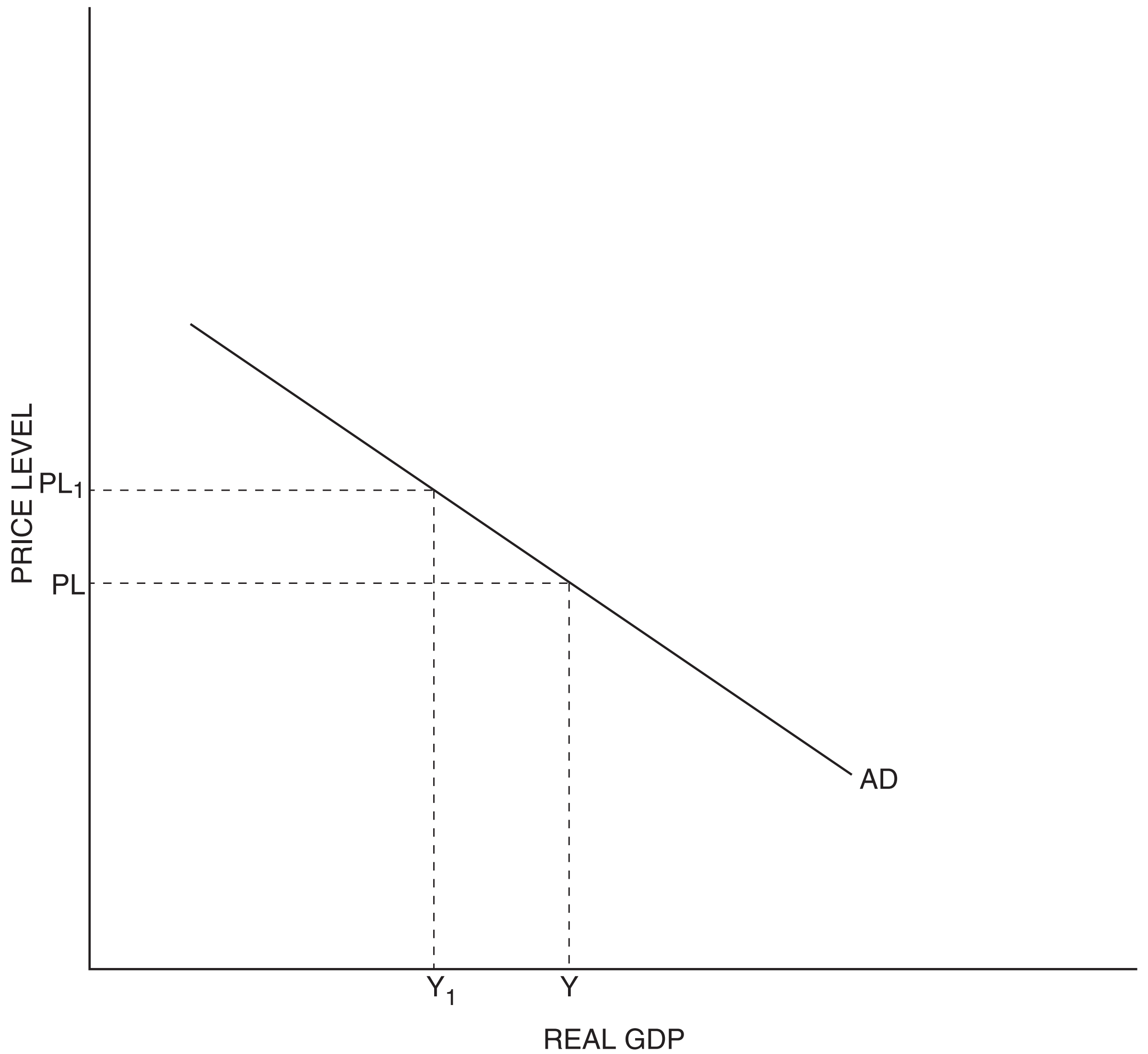
- Not working but actively seeking work
- Frictional
- Cyclical
- Structural

OUT
of the labor force



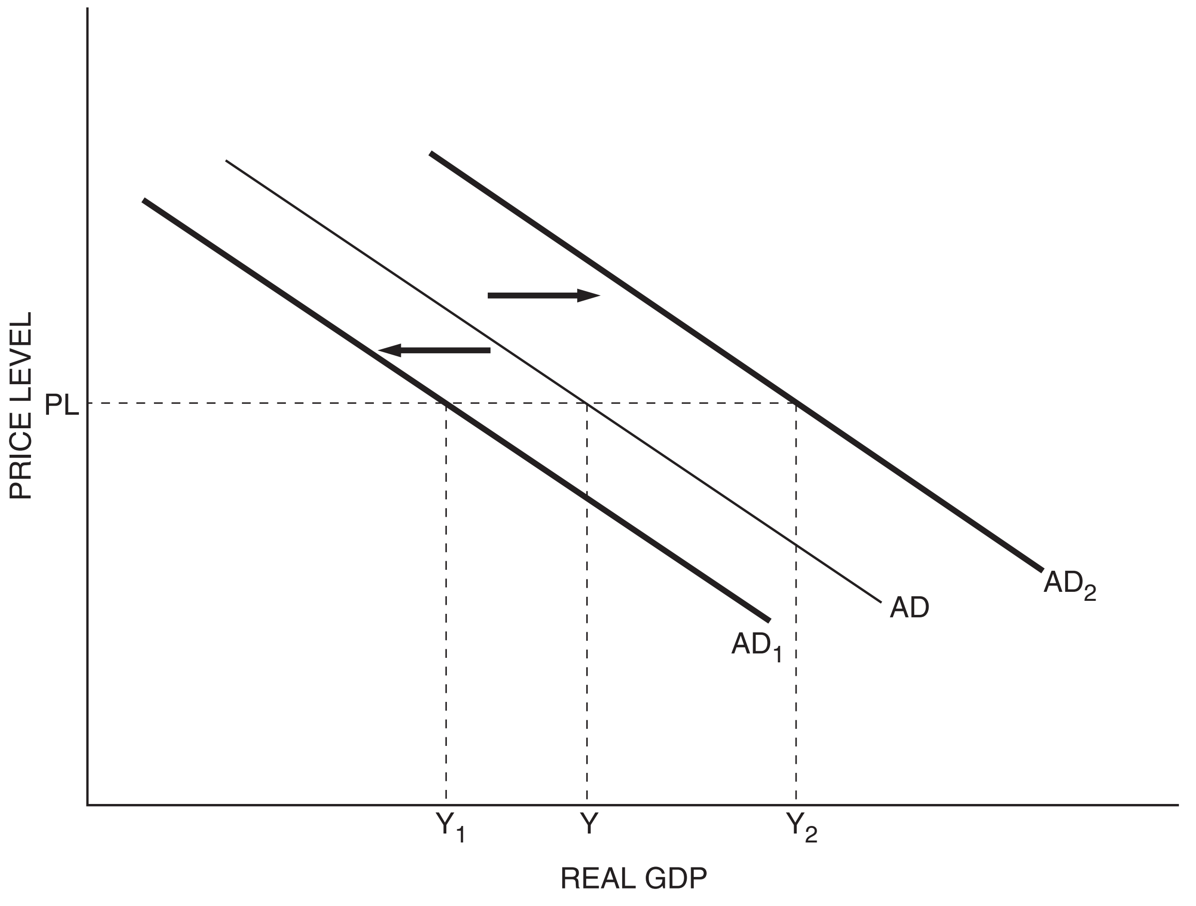
- Children
- Retired
- Full-time student (not working)
- Choose not to work
- Not actively seeking work
- Stay-at-home parent
- Institutionalized
- Discouraged workers

Aggregate Demand



An increase in price from PL to PL_1 results in a decrease in real GDP from Y to Y_1.

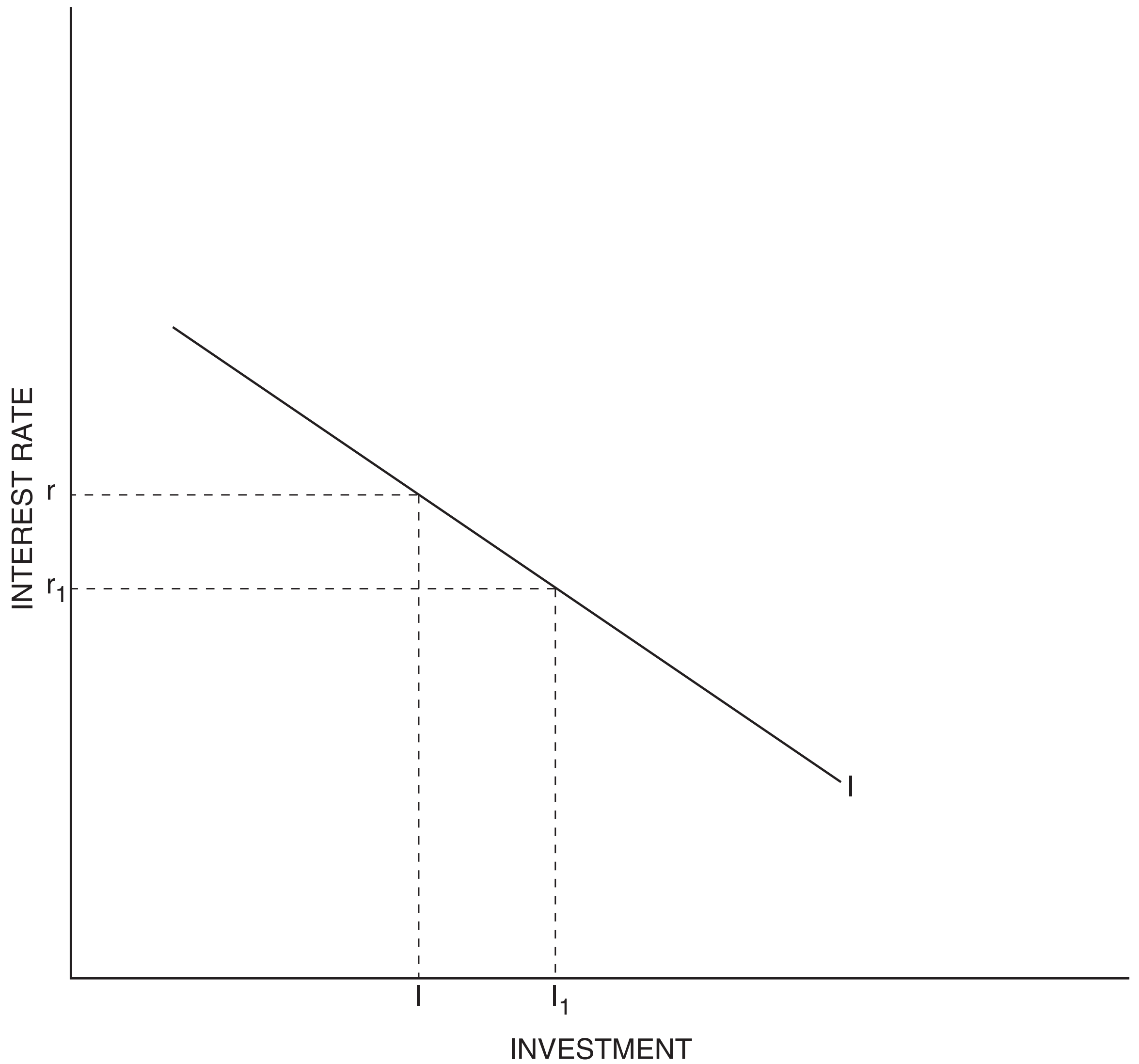
Shifts in Aggregate Demand



A decrease in expected future income, in government expenditures, or in the money supply or an increase in taxes will cause the AD to shift from AD to AD_1.

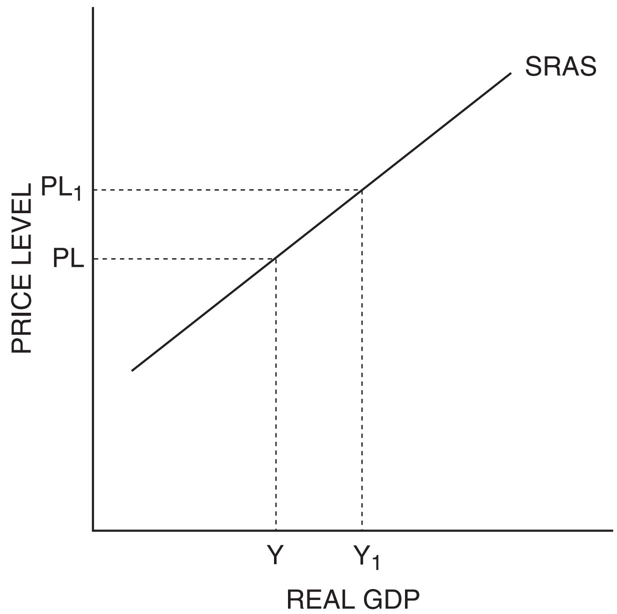
An increase in expected future income, in government expenditures, or in the money supply or a decrease in taxes will cause the AD to shift from AD to AD_2.

Investment Demand

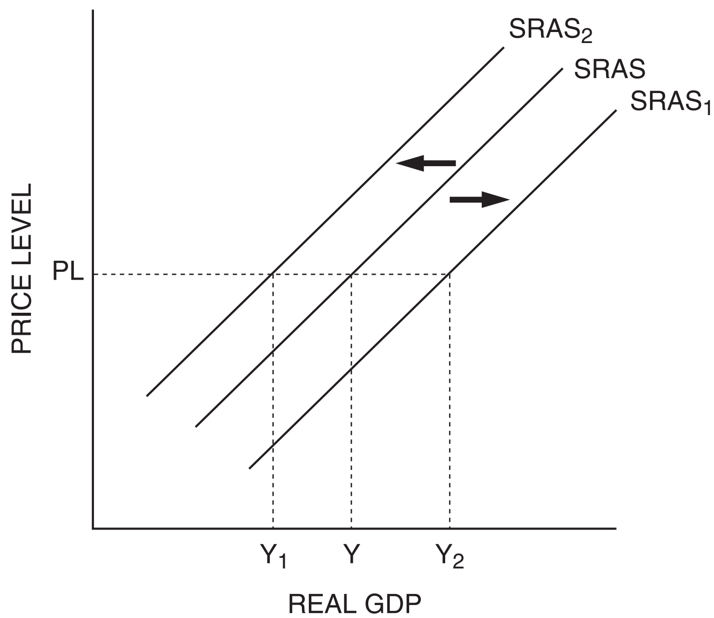


An interest rate decrease from r to r_1 results in an investment increase from I to I_1.

Aggregate Supply

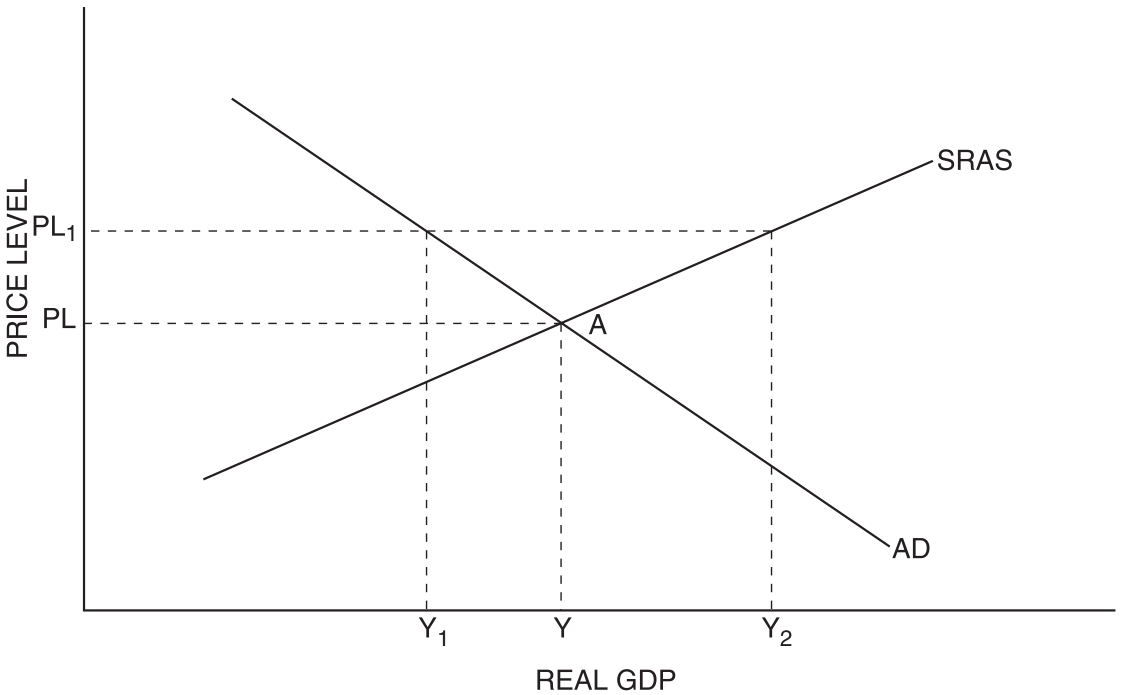


An increase in price from PL to PL_1 results in an increase in real GDP from Y to Y_1.

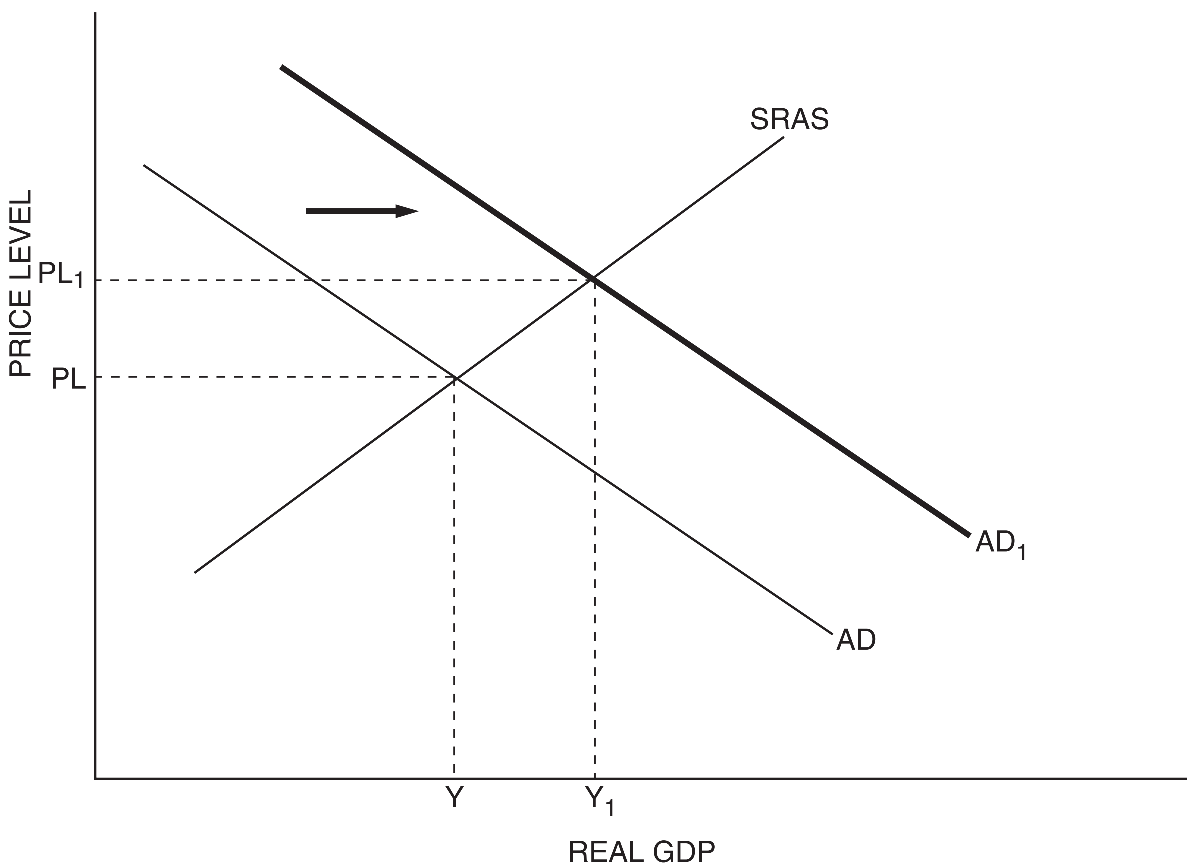


A decrease in resource prices or a technological advance will shift the SRAS to $SRAS_1$.

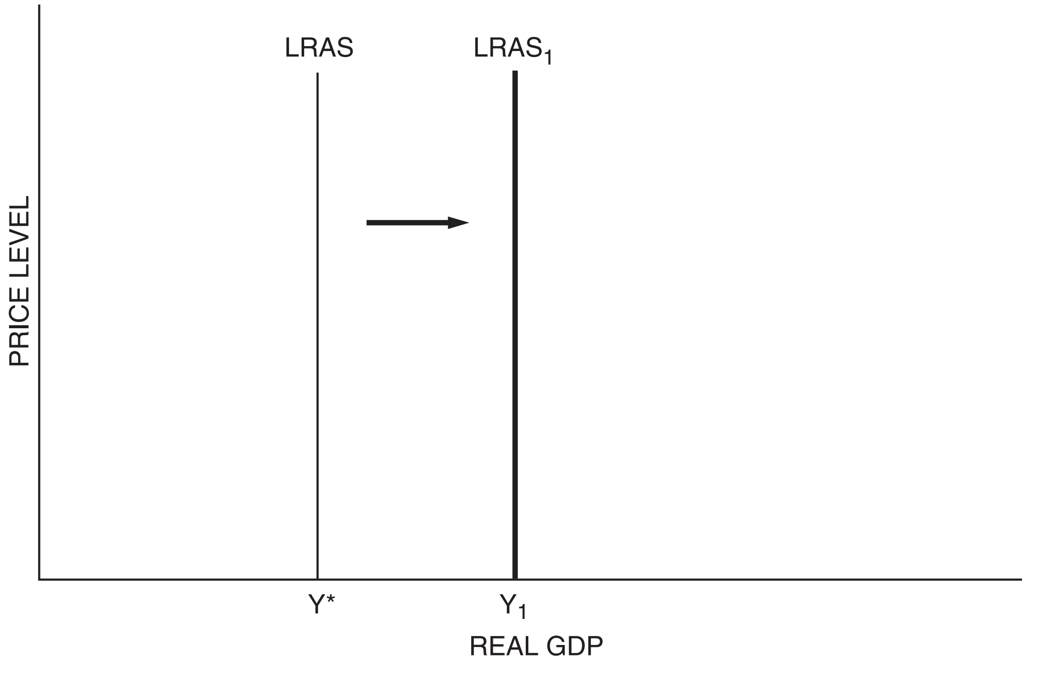
Short-Run Equilibrium



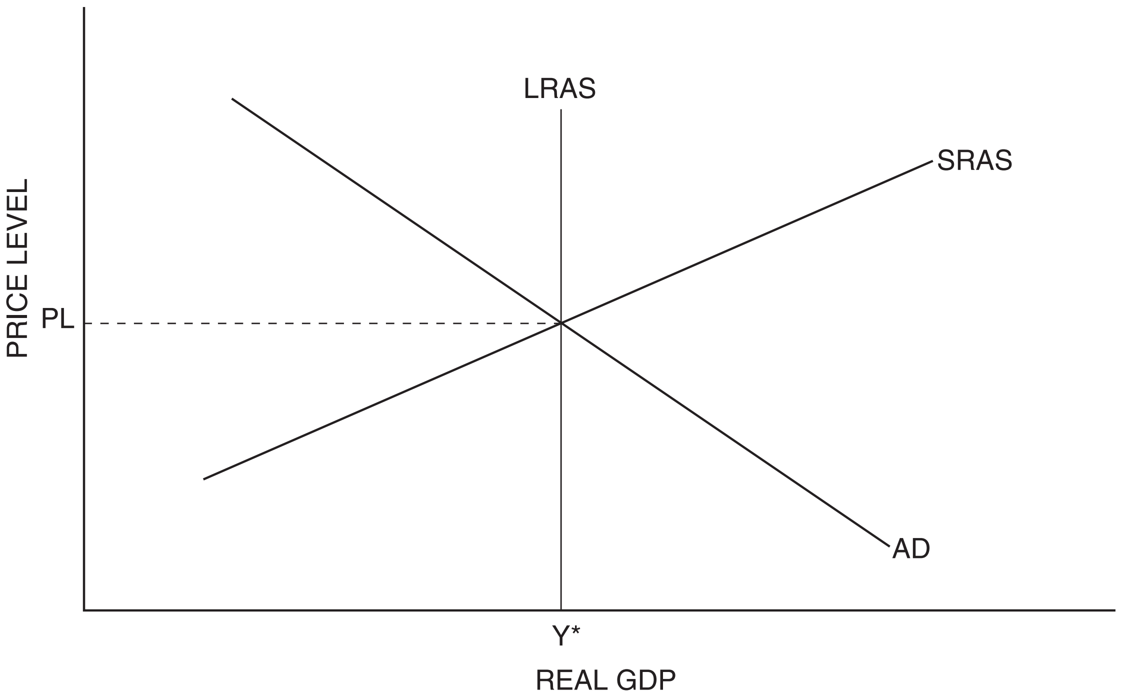
Change in Aggregate Demand



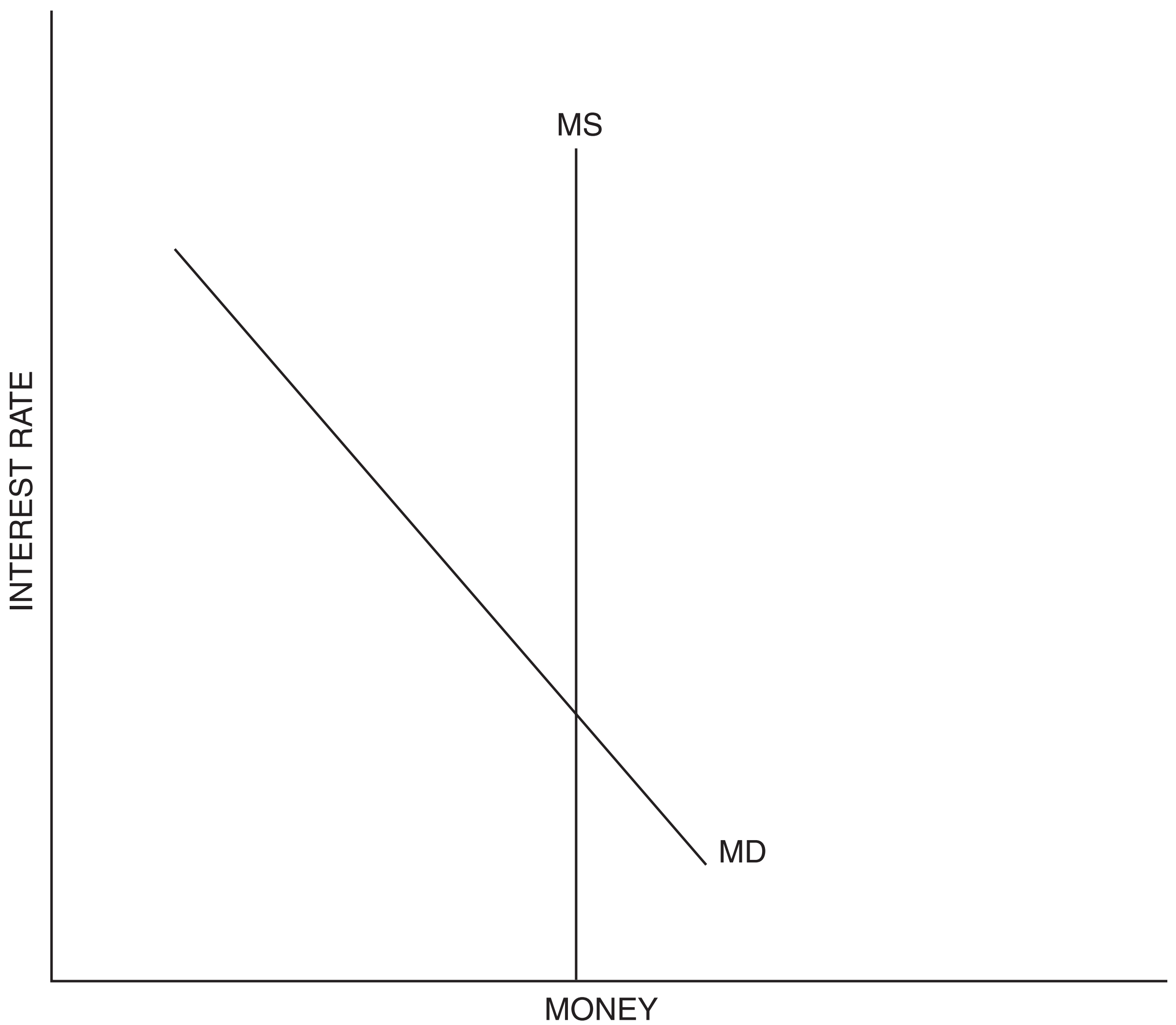
Long-Run Aggregate Supply



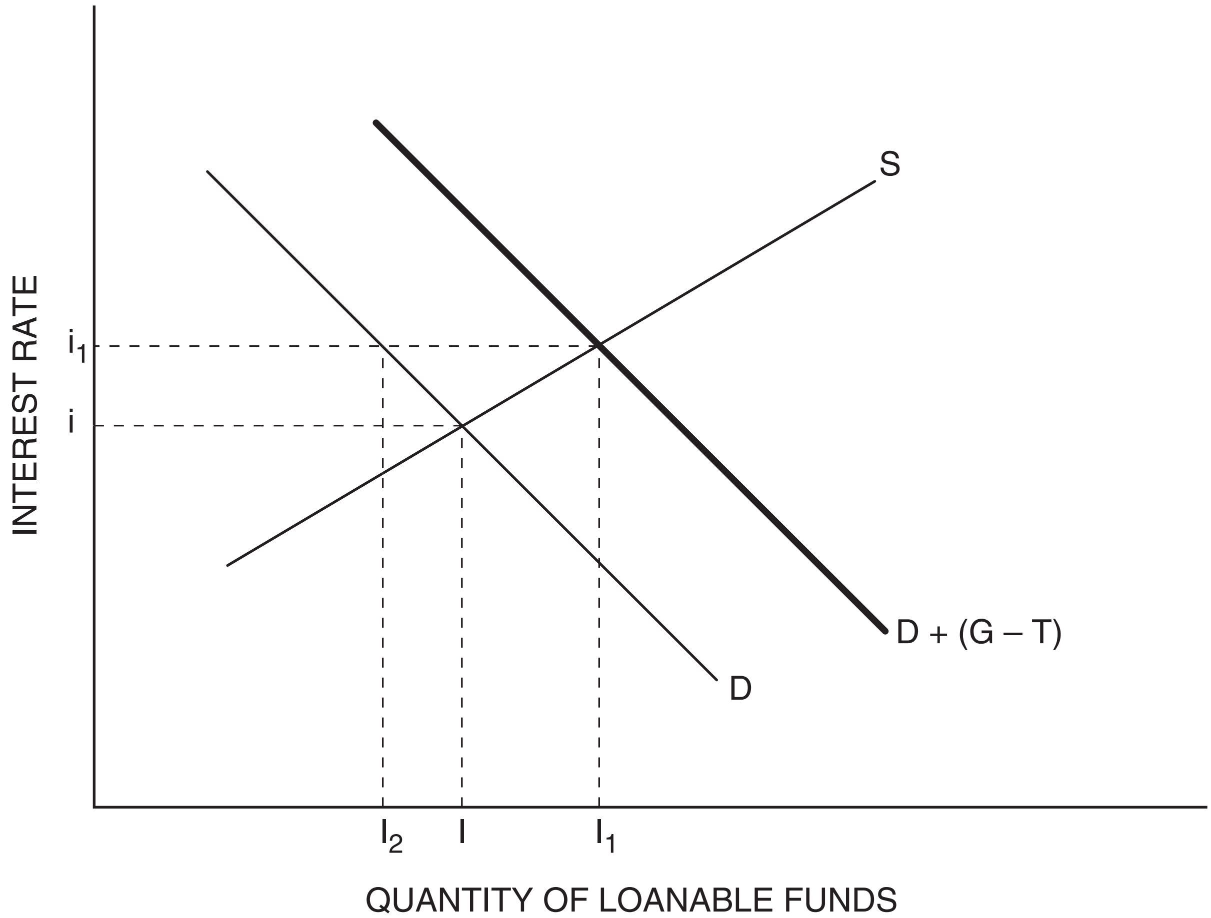
Long-Run Equilibrium



The Money Market



Loanable Funds Market



I and i are the initial equilibrium values.

D = private sector demand for funds (investment).

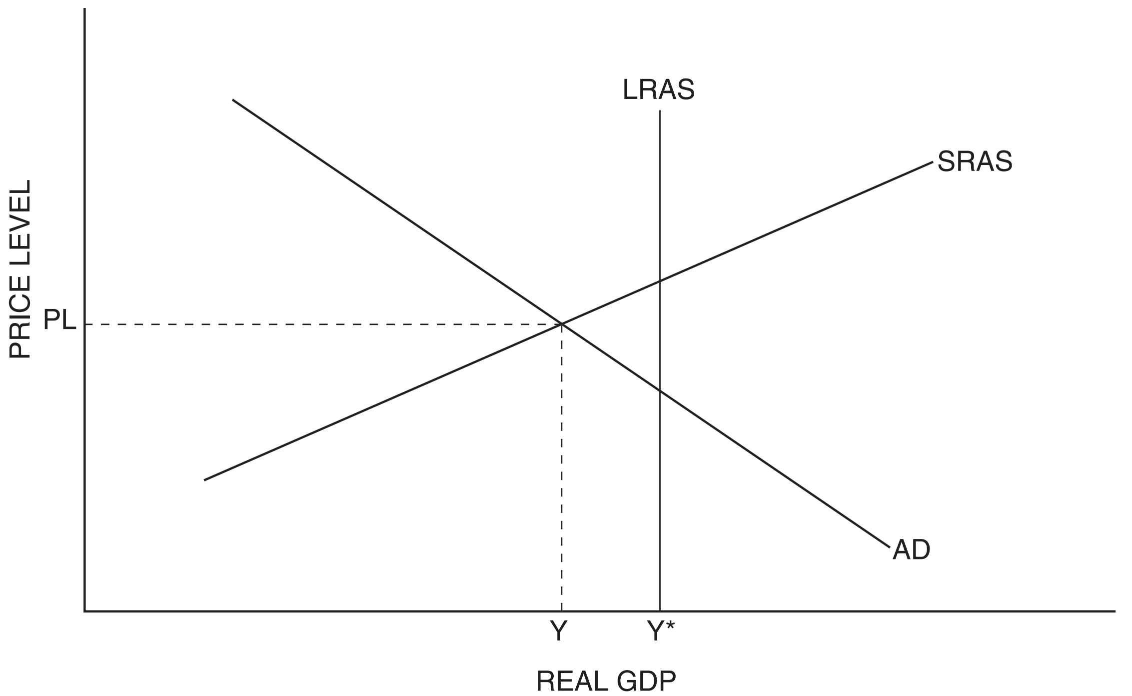
D + (G – T) = private + government demand for funds.

I_1 and i_1 are the new equilibrium values.

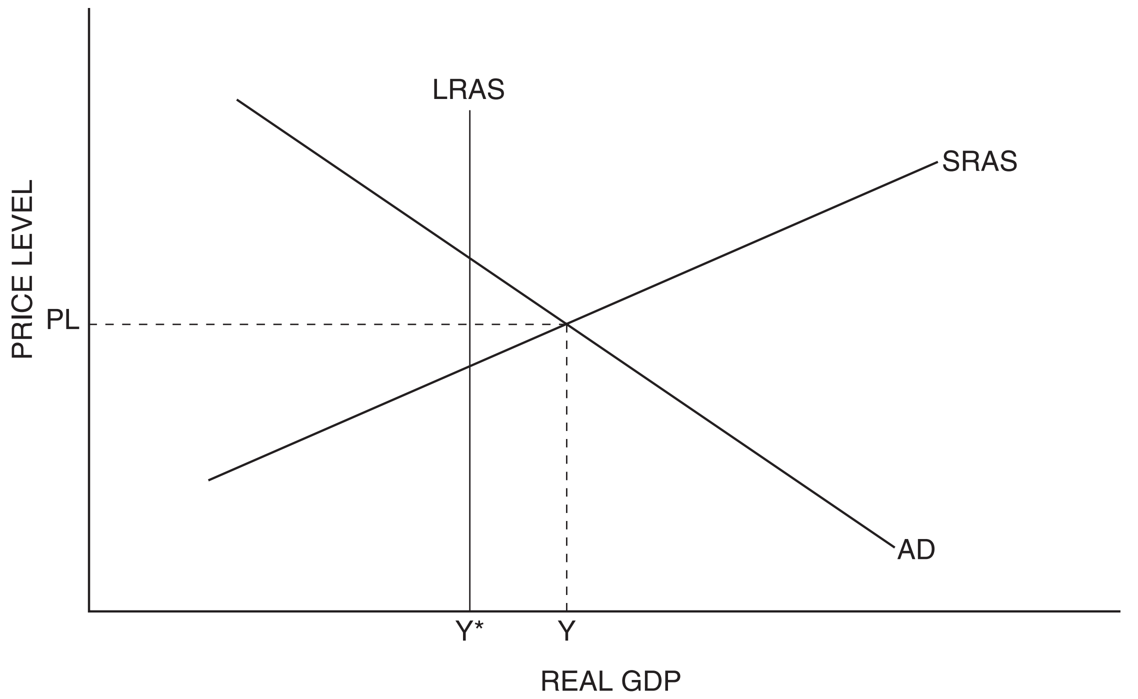
I_2 = new level of private investment.

$I_1 - I_2$ = government demand for funds (G – T).

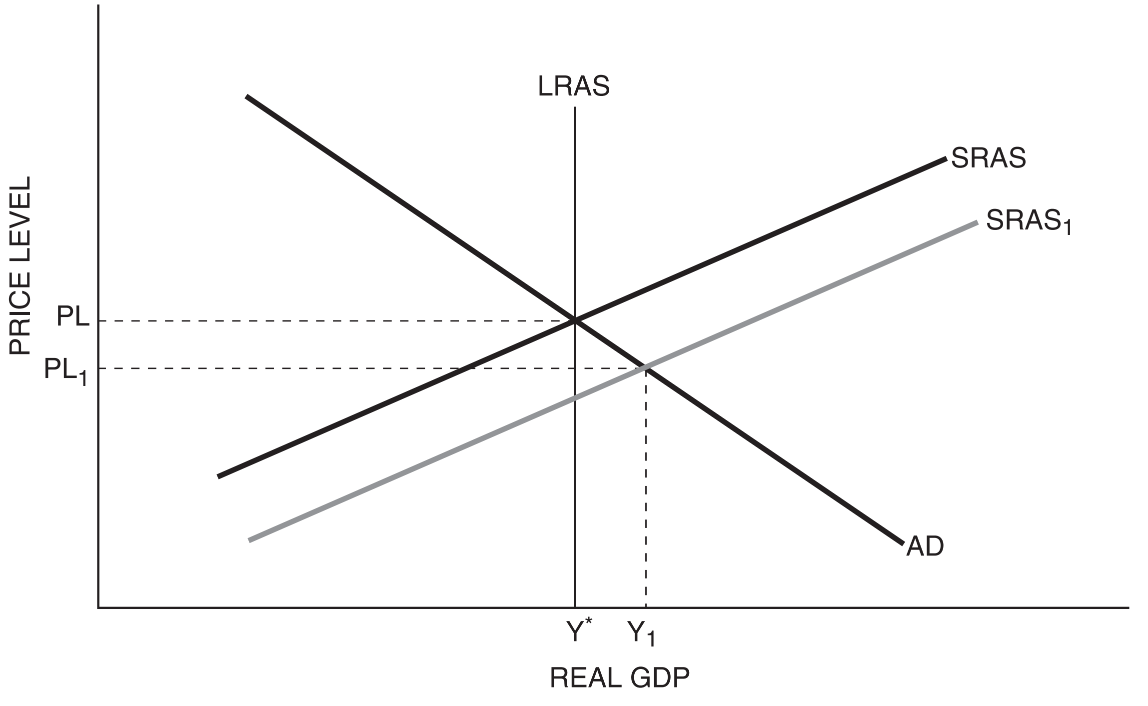
Expansionary Fiscal Policy



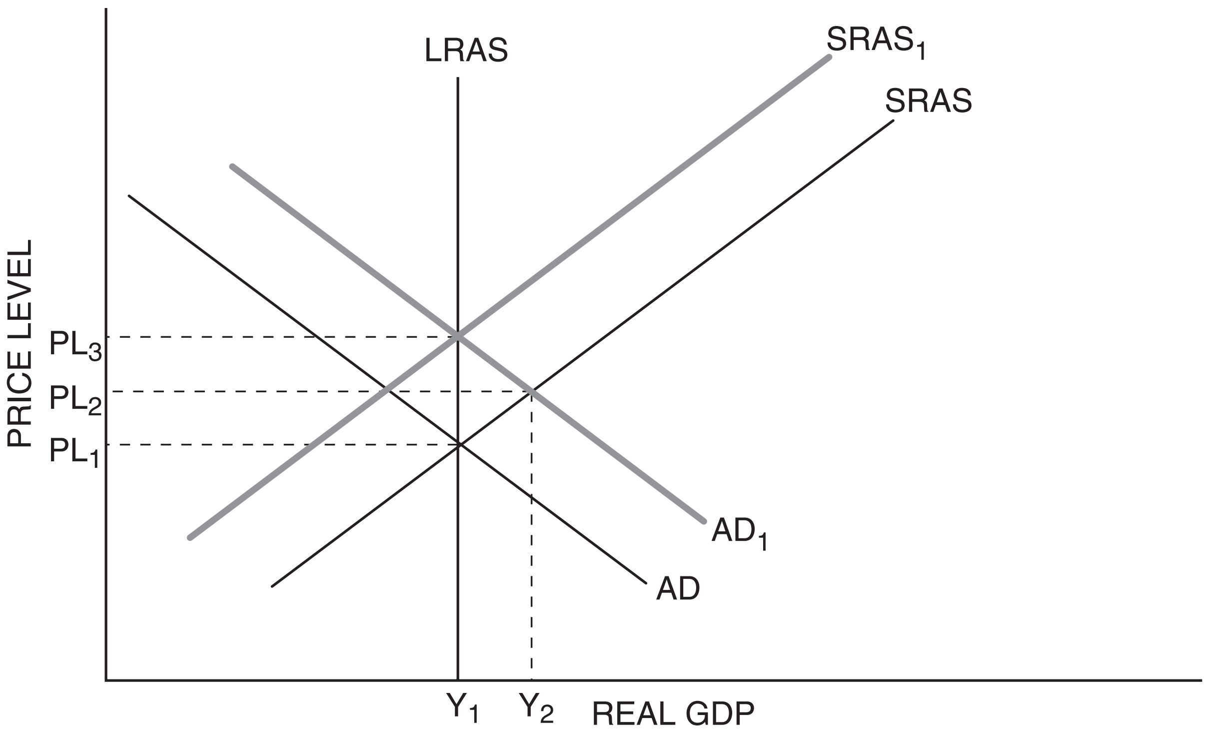
Contractionary Fiscal Policy



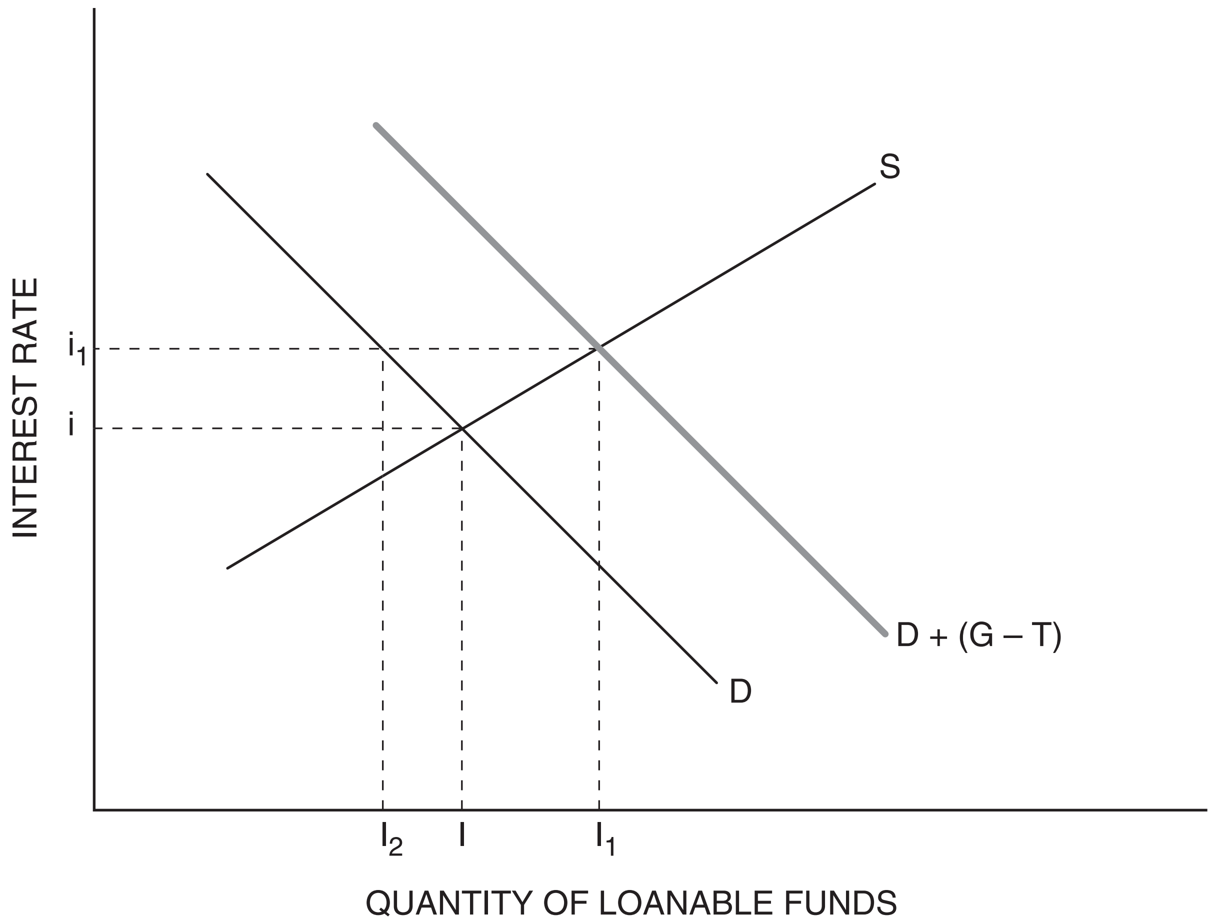
Increasing Aggregate Supply



Long-Run Adjustment of Aggregate Supply



Loanable Funds Market



I and i are the initial equilibrium values.

D = private sector demand for funds (investment).

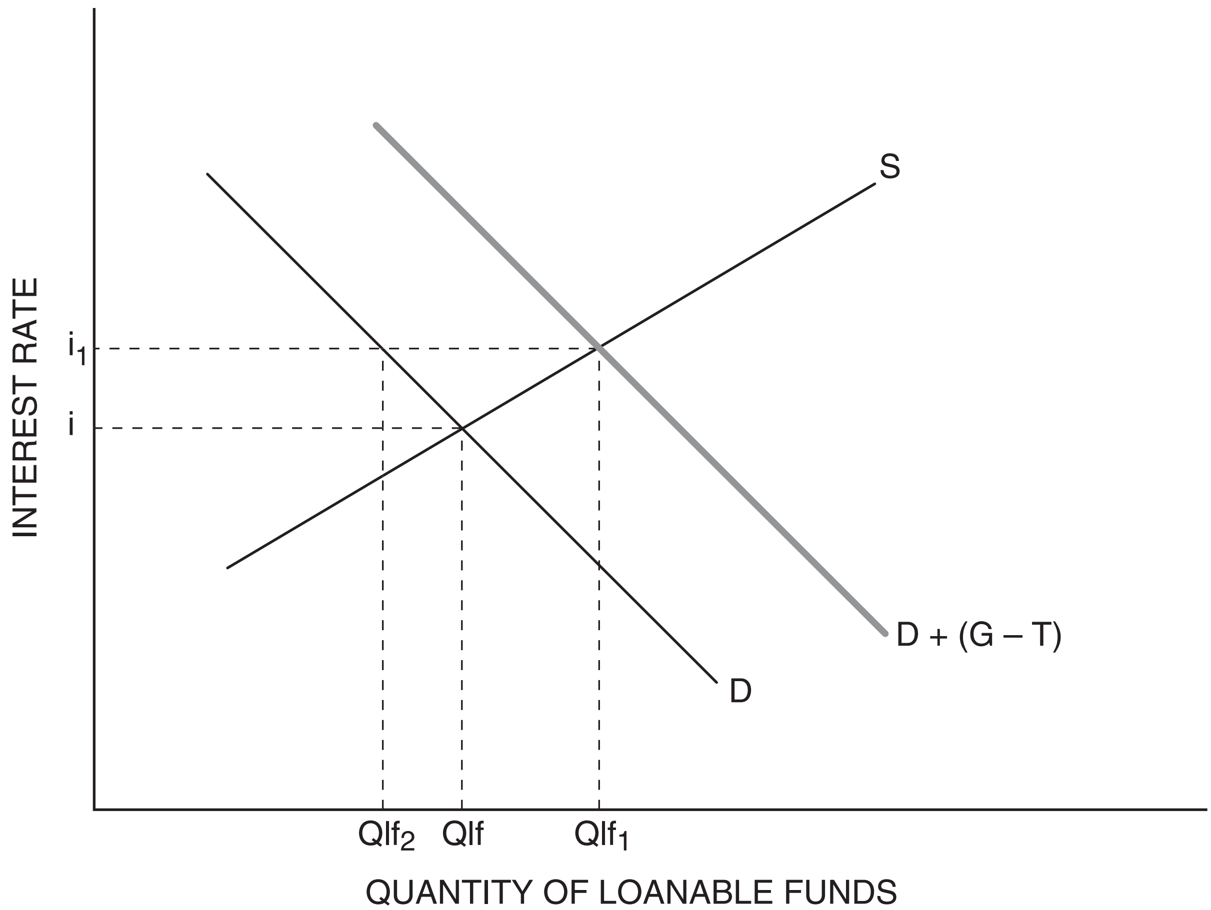
D + (G – T) = private + government demand for funds.

I_1 and i_1 are the new equilibrium values.

I_2 = new level of private investment.

$I_1 - I_2$ = government demand for funds (G – T).

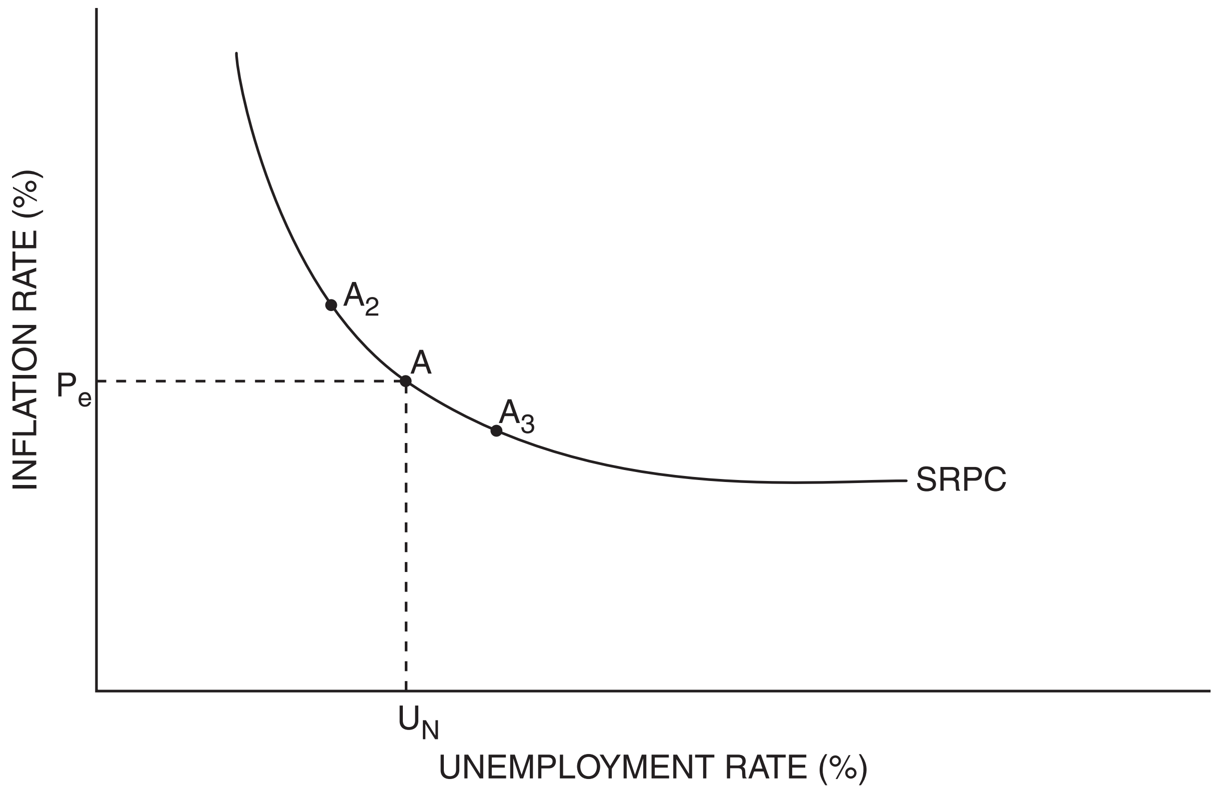
Loanable Funds Market



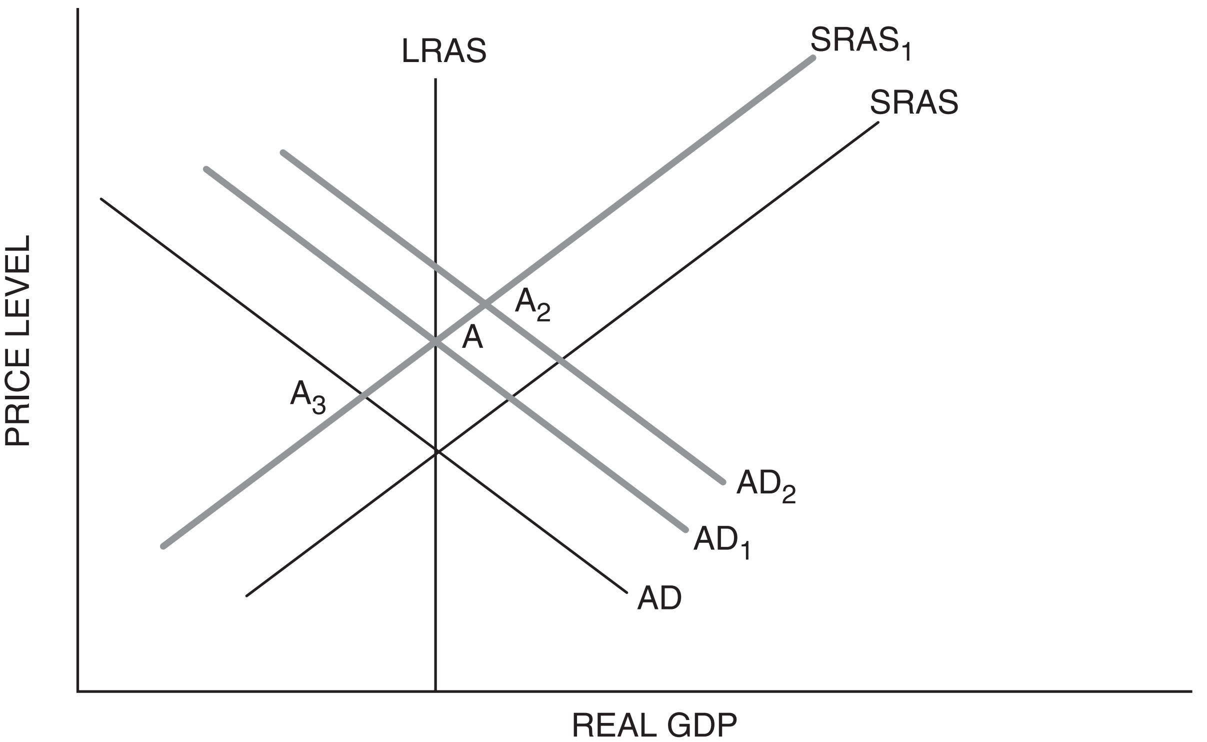
Data for a Phillips Curve

Unemployment rate (%)	Inflation rate (%)
5.54	1.7
6.69	1.1
5.57	1.2
5.64	1.2
5.16	1.3
4.51	1.6
3.79	2.9
3.84	3.1
3.56	4.2
3.49	5.5

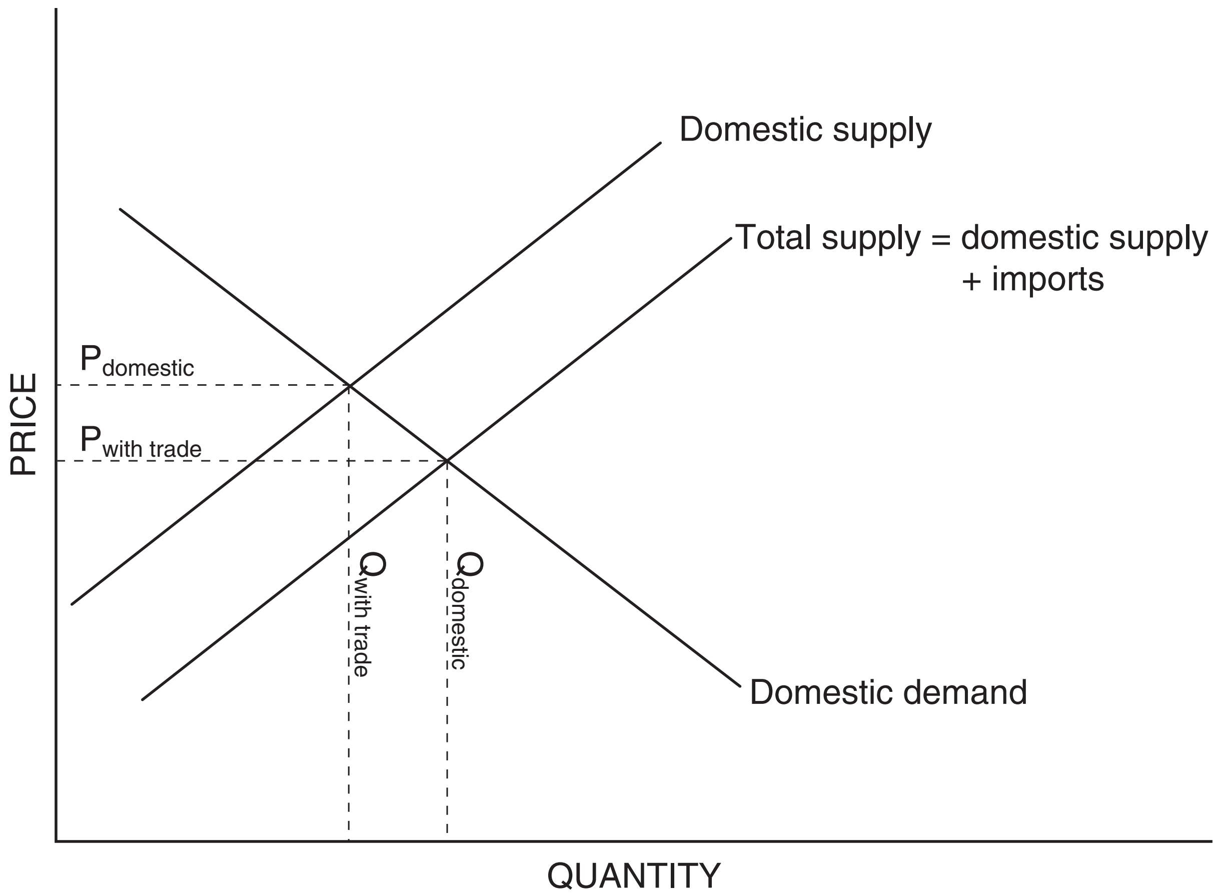
Short-Run Phillips Curve



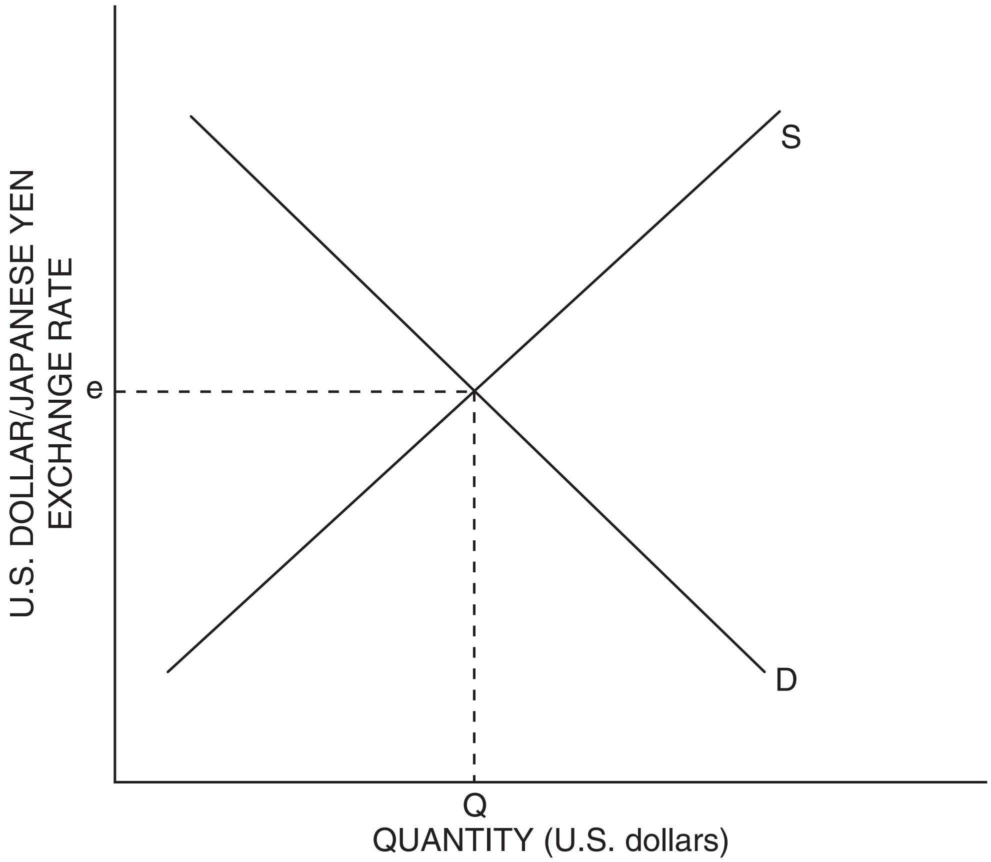
Short-Run Phillips Curve



Domestic and Foreign Supply



Supply and Demand in the Foreign Exchange Market



The supply of U.S. dollars is determined by U.S. demand for foreign goods, services, and investments.

The demand for U.S. dollars is determined by foreign demand for U.S. goods, services, and investments.