# Why Study Macroeconomics?

*by Sophia Tutorial*

WHAT'S COVERED

This tutorial will cover the importance of studying and understanding macroeconomics, in order to be an informed and educated participant in society.

Our discussion breaks down as follows:

1. Economic Indicators
2. Economic Policy and Business Cycles
3. International Impact: Global Trade and Capital Flow

## 1. Economic Indicators

Whenever you hear or see news about the economy in the media, such as the Fed cut interest rates for the third time this year, or the unemployment rate fell to 7.9% this quarter, it generally falls under the category of macroeconomics, because these issues involve how the economy is functioning overall.

When we truly understand the meaning and impact of these statements, we become better citizens because we are educated about them and are better able to participate in our government and society.

Often, students come into an economics course knowing how they feel about social issues. You very well may know, for instance, whether you are socially conservative or liberal. However, how you feel about the economy and economic policies is just as important--sometimes even more important--when deciding how to vote.

Now, key **economic indicators** are the things reported in the media that help provide a picture of what the economy is doing, and as mentioned above, it is crucial to understand what they are telling us.

There are three different kinds of economic indicators, but all of them are data specific to some economic outcome or behavior that indicate the direction of past, present, or future economic activity:

- Lagging indicator (past)
- Coincident indicator (present)
- Leading indicator (future)

EXAMPLE A few examples of economic indicators that you may be familiar with are the unemployment rate, the inflation rate, and the stock market. Also, a more specific example would be new building permits. We will discuss all of these in this macroeconomics course.

It is very important to understand how our economy functions overall because we can only participate in something effectively when we understand how it functions.

If, for example, you hear that interest rates might rise in the near future, and you do not know how that might impact you, then you are not effectively participating in society. It is important for you to understand that an issue like this might impact your spending and saving habits now, or in the future, when they do rise--important to you personally, and also as a participant in the economy.

TERM TO KNOW

**Economic Indicators**
Data specific to an economic outcome or behavior that provide an indication of the direction of past (lagging indicator), present (coincident indicator), or future (leading indicator) economic activity

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# 2. Economic Policy and Business Cycles

When our government or Federal Reserve System decides to enact some economic policy, we need to be able to understand *why* they are doing it and *how* it is expected to help the economy.

THINK ABOUT IT

For instance, why might the government cut taxes during a recession? Alternatively, why might the Federal Reserve System look to increase interest rates once the economy has rebounded from a recession?

There are two different kinds of economic policies that work to stabilize the economy and make sure that we maintain movement through the natural business cycle:

- **Monetary policy**: Policy typically set by a central banking authority--like the Federal Reserve System--whereby money supply access and the resulting cost or access to money, which is the interest rate, is varied to assist in stabilizing economic activity. Essentially, monetary policy works through interest rates and our money supply.
- **Fiscal policy**: Policy determined by the central government, where government spending and taxation can be adjusted to stabilize economic activity through our business cycles.

HINT

The Federal Reserve System is a monetary policy and our federal government is the body which makes decisions for fiscal policy.

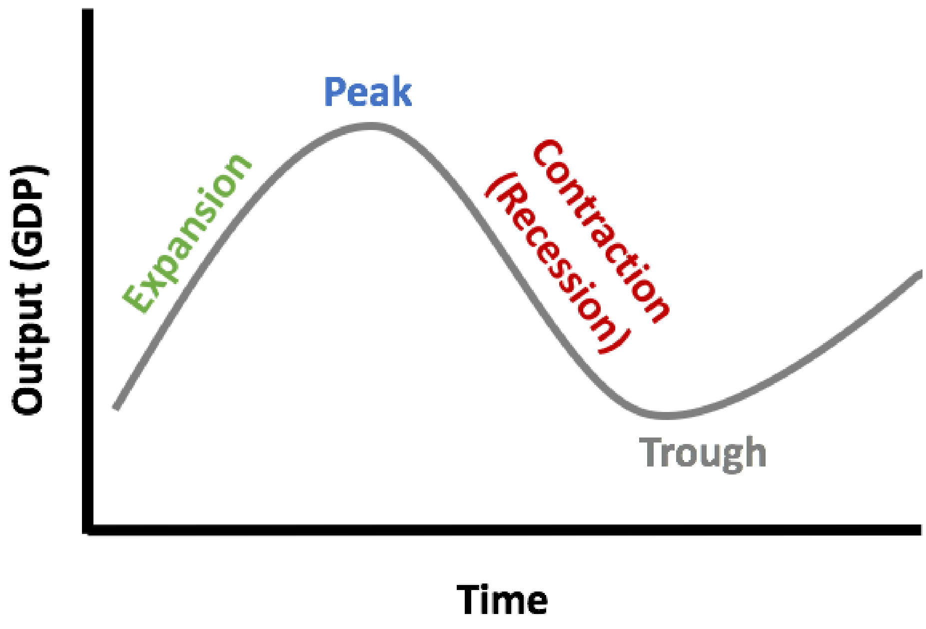
It is important to understand that both of these can be valuable in helping our economy move through the natural business cycle, and that, for example, we are not stuck in a recession for a significantly extended time.

**Business cycles** are the movement of an economy through a cycle, consisting of expansion, peak, contraction, and trough. Then, the process repeats itself, as the name "cycle" indicates.

HINT

Business cycles are essentially an assessment of economic activity through time.

This is what a business cycle looks like; the vertical axis is the economy's output and the horizontal axis represents time.




As you can see, as the economy is producing more, it is in expansion and it ultimately peaks. Then, as output shrinks, there is a brief contraction. If it lasts longer, it's called a recession. Finally, there is a bottoming out, or a trough, and the cycle repeats itself.

It is usual for the economy to go through periods of growth and contraction like this. As the economy is moving in these cycles, most people are concerned about issues like the unemployment rate and inflation.

TERMS TO KNOW

**Monetary Policy**
Policy typically set by a central banking authority, whereby money supply access and the resulting cost or access to money (interest rate) is varied to assist in stabilizing economic activity

**Fiscal Policy**
Policy typically set by a central government authority whereby government spending is adjusted to stabilize economic activity

**Business Cycles**
The movement of an economy through expansion, peak, contraction, and trough over time; an assessment of economic activity through time

# 3. International Impact: Global Trade and Capital Flow

Lastly, let's discuss the issue of international impacts in the macroeconomy.

Most people today are well aware that countries are interconnected. Our economy is very much tied to the economies of nations worldwide, and we certainly have a significant impact on those nations as well. Almost everyone in the world is concerned about the United States economy because when something happens in the U.S., you can be assured that it is going to impact economies worldwide.

Therefore, it's important to understand concepts like international trade and the flow of capital among nations. Note, we will have separate tutorials on both of these, but let's briefly define them here.

**Global trade**, or international trade, is trade that occurs across nations, typically involving foreign exchange transactions.

- When we purchase goods and services from other nations, we are importing those things.
- When other nations purchase goods and services from us, we are exporting them to other countries.

This is the flow of goods and services between countries.
**Capital flow** is a bit different because it's not necessarily goods and services moving between countries, but rather the movement of capital, typically referencing financial capital, into and out of countries.

> EXAMPLE When, for example, countries invest or loan money to other nations, this is the flow of financial capital. This has a huge impact on our economy, and the economies of the other countries, as well. We will certainly be talking about this capital flow throughout macroeconomics.

TERMS TO KNOW

**Global Trade**
Trade that occurs across nations, typically involving foreign exchange transactions.

**Capital Flow**
The movement of capital, typically referencing financial capital, into and out of an entity or country

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SUMMARY

Today we learned how essential it is to understand macroeconomics in order to participate in society. We learned about the key **economic indicators**, as well as how our economy functions overall. We discussed the two types of **economic policy**, monetary policy and fiscal policy, and their role in helping the economy move through the natural **business cycle**. We ended today's lesson by briefly discussing the **impact of international issues** like **global trade and the flow of capital**.

Source: Adapted from Sophia instructor Kate Eskra.

TERMS TO KNOW

**Business Cycles**
The movement of an economy through expansion, peak, contraction, and trough over time; an assessment

of economic activity through time.

**Capital Flow**
The movement of capital, typically referencing financial capital, into and out of an entity or country.

**Economic Indicators**
Data specific to an economic outcome or behavior that provide an indication of the direction of past (lagging indicator), present (coincident indicator), or future (leading indicator) economic activity.

**Fiscal Policy**
Policy typically set by a central government authority whereby government spending is adjusted to stabilize economic activity.

**Global Trade**
Trade that occurs across nations, typically involving foreign exchange transactions.

**Monetary Policy**
Policy typically set by a central banking authority, whereby money supply access and the resulting cost or access to money (interest rate) is varied to assist in stabilizing economic activity.