

Objectives of Macroeconomic Policy

- High level of output (GDP)
- Full employment
- Price stability
- Sustainable balance of Payments
- Rapid Economic Growth



Economic Environment

Economic stages that exists at a given time in a country
Economic system that is adopted by a country for example.

Capitalistic, Socialistic or Mixed Economy

Economic planning, such as five year plans, budgets, etc.

Economic Indices such as National Income, Per Capital Income,
Disposable Income, Rate of growth of GNP, Distribution of Income,
Rate of savings, Balance of Payments etc.

Economic policies for example, monetary, industrial and fiscal
Policies

Phases of business cycle

Structure of economy



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Economic Systems



Nature of Economic indicators

Timing: Economic Indicators can be leading, lagging, or coincident which indicates the timing of their changes relative to how the economy as a whole changes.

Leading: Leading economic indicators are indicators which change before the economy changes. Stock market returns are a leading indicator, as the stock market usually begins to decline before the economy declines and they improve before the economy begins to pull out of a recession. Leading economic indicators are the most important type for investors as they help predict what the economy will be like in the future •



Measures of Aggregate Income

- Gross Domestic Product (GDP)
- Gross National Product (GNP)
- Net National Product (NNP)



International Monetary Fund (IMF)

- *What they do*

- Through its economic surveillance, the IMF keeps track of the economic health of its member countries, alerting them to risks on the horizon and providing policy advice. It also lends to countries in difficulty, and provides technical assistance and training to help countries improve economic management. This work is backed by IMF research and statistics (188 countries globally).

- *Our Work*

- The IMF's fundamental mission is to help ensure stability in the international system. It does so in three ways: keeping track of the global economy and the economies of member countries; lending to countries with balance of payments difficulties; and giving practical help to members.



Example

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Assume economy only produces apples and pears. The price for an apple is \$2 in 2000, whereas the price for a pear is \$3. Same year we produce 100 apples and 50 pears. In 2005, because of the inflation the price for an apple goes up to \$3, whereas the price for a pear is \$4 at the same production levels.

The nominal GDP in 2000 is \$350 and the nominal GDP in 2005 is \$500. However real GDP did not change, because real GDP only changes with the changing production level and therefore is a better size measure for economy.



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Money supply is basically determined by the central bank of a country (e.g. Reserve Bank of Australia) and the commercial banking network.

RBI has adopted four measures of money supply viz.-M1, M2, M3 and M4 .

M3 (broad money) is most popular from operational point of view. M3 includes time deposits (fixed deposits), savings deposits with post office saving banks and all the components of M1.



Factors affecting Money supply

Bank credit

Deficit financing

Foreign exchange reserves

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Inflation

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A sustained increase in the general level of prices so that a given amount of money buys less and less.

Reasons of inflation

1. inflation caused by monetary expansion (monetary inflation)
2. inflation caused by real demand expansion
3. inflation caused by aggregate supply contraction



Remedies - Real Demand Inflation

If inflation is caused by strong real demand, the best response may be to support aggregate supply growth. Part of the solution may be to let prices rise. Suppliers need incentives to invest in new capacity.

Stimulating aggregate supply include encouraging business investment; reducing input costs; and increasing competitive intensity.

If aggregate supply is sufficiently stimulated, inflation may be converted into balanced economic growth:

If instead money supply is tightened in the face of strong real demand, the result will be a surge in interest rates, which may be counterproductive in this case, as it will be harder for aggregate supply to expand when borrowing costs are high.



Real & Nominal Interest rates

Real Interest Rate = Nominal Interest Rate – Inflation

Real interest rate, is one where the effects of inflation have been factored in. A nominal variable is one where the effects of inflation have not been accounted for.

