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Economics 202

4 Macro Markets – Intro

In microeconomics, we typically focus on one market at a time, and that discussion often involves a demand and supply graph. In macroeconomics, we have the entire economy to consider, so it's more appropriate to juggle several graphs at the same time since so much is going on at any given moment.

The 4 macro markets section is designed to provide us with that more general focus, where we examine the following areas of the economy:

Goods and services: where we look at the overall demand and supply of goods and services in our country, and talk about things like recessionary or inflationary gaps.

Factors of production: where we examine the market for factors like labor, and better understand concepts like unemployment, as well as the link between production and the hiring of factors like labor.

Loanable funds: which relates to the demand and supply of loanable funds, where demanders are the households, firms and government who borrow money to ultimately pay for their expenditure, and the suppliers are the financial institutions who loan out those funds.

Foreign exchange: where we consider our demand and supply for a specific foreign currency, which we call the foreign exchange. This market relates to the trade of goods and services between our two countries and the flow of investment dollars (i.e. capital spending) between those countries. Trade and capital flows fit this market because in order to purchase goods or services from another country, we need to trade our currency for their currency.

The central market is Goods and Services, which considers the buying and selling of goods and services within a given country (e.g. the US) and ultimately answers the question of how much GDP a country should produce. Of course, the answer to that question in an economics course is that we should produce the equilibrium level of GDP, so we must find that equilibrium. On the demand side, we have various types of expenditure which reveal the level of demand for different groups within the economy (i.e. households, firms and government). In the short run, that equilibrium will change when people increase or decrease their spending, so given that both fiscal and monetary policy are designed to change expenditure, we can use the Goods and Services market to analyze the effects of these policies on GDP.

It's also important to note that these markets are all related. E.g., a shift in the demand for loanable funds will lead to changes in interest rates, which affects investment expenditure and capital flows, and ultimately the overall demand for Goods and Services. Of course, changes in the Goods and Services market can lead to changes in these other markets as well. E.g., if the demand for Goods and Services falls, then this can lead to a decrease in the demand for labor (since labor demand is derived from a firm's output decision) and a decrease in imports (since there's a positive relationship between imports and income). If government decides to increase government spending, and then finance that expenditure by borrowing money from the loanable funds market, then there will also be a shift in the demand for loanable funds.

These markets illustrate the interconnectedness of the macroeconomy, and help us better understand how everything relates.