

Principles of Economics
Macroeconomics
Business-Cycle Recap

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Key Equations and Concepts

- A general glut: $Y > E$: projected income greater than planned expenditure...
- A general glut: a general desire to build up cash holdings, to leverage up...
- Opposite of a general glut: an inflationary gap. Too-much money chasing too-few goods
- $E = C(Y-T, r) + I(r) + G + X(\varepsilon)$: $\varepsilon = \varepsilon(r)$: $r = i + E(\Delta i) + \rho - E(\pi)$
- In short-run equilibrium: $Y = E$
- In SRE: $Y = \mu[c_0 + (G - c_y T) + (I + c_w W + X)(r)]$: $\mu = 1/(1 - c_y)$

Key Equations and Concepts II

- Government chooses G, T
- Household optimism/pessimism determines c_0
- Foreigners affect X , financial markets
- Federal Reserve chooses i , affects $E(\Delta i) + \rho - E(\pi)$
 - Federal Reserve and financial markets together determine r
 - Federal Reserve moves last...

Key Equations and Concepts III

- Aggregate Supply:
 - As long as $Y < Y^*$ potential output, $P = P_{-1} \times (1 + E(\pi) + SS)$
 - When $Y = Y^*$, $P > P_{-1} \times (1 + E(\pi) + SS)$
- Or possibly:
 - $\pi = E(\pi) + \beta(u^* - u)$
 - But recently: $\pi = \max(\pi_{\text{floor}}, E(\pi) + \beta(u^* - u))$

What Was I Thinking?

- The huge hole was the lack on my part of any consideration of the possibility that we might not do what was necessary to rebalance aggregate demand at full employment in a short-run of two to three years...
- I simply assumed that the political and economic logic would work together:
 - The political logic was that all incumbents of whatever party were at grave risk in the next election if unemployment remained high...
 - The economic logic was that expansionary fiscal policy would get spending up to potential output
 - I thought it obvious: (i) that inflation was not a threat unless and until unemployment reapproached its natural rate, (ii) that the multiplier was one or more in the absence of monetary-policy offset, and (iii) that even deficit hawks would recognize that as long as long-term real interest rates stayed low the market was telling us that worrying about the projected future debt-to-GDP ratio was not appropriate...
- These all seemed to me to be barely worth noting, or not even worth noting.