KEY IDEAS

- Macroeconomics is the study of the economy as a whole; microeconomics is the study of individual parts of the economy such as businesses, households and prices. Macroeconomics looks at the forest; microeconomics looks at the trees.
- A circular flow diagram illustrates the major flows of goods and services, resources and income in an economy. It shows how changes in these flows can alter the level of goods and services, employment and income.
- Gross domestic product (GDP) is the market value of all final goods and services produced in a nation in one year. It is the most important measurement of production and output.
- GDP counts only final goods and services; it does not count intermediate goods and services.
- GDP also does not count secondhand goods; the buying and selling of stocks and bonds; and transfer payments such as Social Security benefits, unemployment compensation and certain interest payments.
- GDP includes profits earned by foreign-owned businesses and income earned by foreigners in the United States, but it excludes profits earned by U.S.-owned companies overseas and income earned by U.S. citizens who work abroad.
- GDP may be calculated in two ways:
  1. Add all the consumption, investment and government expenditures plus net exports or
  2. Add all the incomes received by owners of productive resources in the economy.
- Price indexes measure price changes in the economy. They are used to compare the prices of a given bundle or market basket of goods and services in one year with the prices of the same bundle or market basket in another year.
- A price index has a base year, and the price level in that year is given an index number of 100. The price level in all other years is expressed in relation to the price level in the base year.

$$\text{Price index number} = \frac{\text{weighted cost of base-period items in current-year prices}}{\text{weighted cost of base-period items in base-year prices}} \times 100$$

- The most frequently used price indexes are the GDP price deflator, the consumer price index (CPI) and the producer price index (PPI).
- Real GDP is adjusted for price changes; nominal GDP is not adjusted for price changes.
- Inflation is a general increase in the overall price level.
- Savers, lenders and people on fixed incomes generally are hurt by unanticipated inflation; borrowers gain from unanticipated inflation.
- Unemployment occurs when people who are willing and able to work cannot find jobs at satisfactory wage rates.
- Unemployment is classified into three categories: frictional, cyclical and structural.
- The unemployment rate represents people who are not working but who are actively looking for a job.
- Full employment is not defined as zero unemployment because frictional and structural unemployment exist even with zero cyclical unemployment.

- The unemployment rate at full employment is called the natural rate of unemployment.
- The labor force is defined as people who have a job (employed) and people who are actively looking for a job (unemployed). The labor force participation rate is the percentage of the population over the age of 16 that is in the labor force.
- A business cycle describes the ups and downs of economic activity over a period of years.
- The phases of the business cycle are expansion (recovery), peak, contraction (recession) and trough.