The principles of macroeconomics

Economics, Macroeconomics

The principles of macroeconomics include supply and demand, unemployment, interest rates, inflation rates, exchange rates, gross domestic product and many others. The discussion of this paper will be based on these things. The paper will include examples for the readers to understand these points thoroughly. The law of supply and demand is the first principle that I will go through. There are three general laws of supply and demand which Hubert Henderson (1922) enumerates in his book ‘ Supply and Demand’. These are: (a) When, at the price ruling, demand exceeds supply, the price tends to rise.

Conversely, when supply exceeds demand the price tend to fall. (b) A rise in price tends, sooner or later, to decrease demand and to increase supply. Conversely a fall in price tends, sooner or later, to increase demand and to decrease supply. (c) Price tends to the level at which demand is equal to supply. These three general laws of supply and demand are the foundation of all theories in economics. It affects almost all aspects of economics. Economic problems are first subjected to these laws to find a proper approach in solving it. Suppose we will evaluate the effect of the price of DVD players to the demand for DVDs.

Base on the three general laws, an increase in the price DVD players will decrease the demand for DVDs. The increase in the DVD players’ price will decrease the demand for the players. That would mean that fewer people would want to buy a DVD player. Since the demand for players decreases, the demand for DVDs would decrease with other factors held constant. We now study the effect of an increase in the price of gasoline to the demand to transportation. The price hike in gasoline would definitely decrease the demand for public transportation.

Note that we are talking about public transportation which runs on gasoline. In this case it will definitely decrease the demand for public transportation. The reason is when there is a gasoline price hike; there will be an increase in fare rates. So other people that can't afford to pay for the increase in fare will tend to search for other means of transportation like riding a bicycle instead, car pooling or a mass transits that do not use gas. Many factors have to be considered when you evaluate relations of demands of two products.

Some would say that an increase in the price of orange juice won't affect the demand for soft drinks. The prediction would be precise if there are other flavors of juice that are available in the market and if the other flavors has an equal demand in the market. But in the case of higher demand of the orange juice than the other flavors and or or there are limited number or no other flavor of juice available in the market, consumers will tends to look for other beverages available such as soft drinks. In summary the supply and demand in relation to price, can evaluated easily if the subject is only one commodity.

But in case of multiple products relating to each other there are more to be consider or you can give your prediction provided that some specific and important factors are held constant. Now let us leave the supply and demand for now and focus on other parts of macroeconomics, even though every one of these things contributes to the supply and demand. These are inflation rate, exchange rate, unemployment and interest rates. They are use by economist evaluate supply and demand more accurately. But now we will only tackle the relationship between them.

These would be just a touch of the surface of everything since it would require a more technical paper to explain it thoroughly. I would put it as how I see and understand it. We will start-off with the inflation rate. The inflation rate as I would put it is the rate of change that commodity prices or value of yourmoneygo through over time. It dictates a lot of things. It affects the interest rates by giving a benchmark. It means that if the interest rate of the money you invest or save fall under the inflation rate you are losing money over time. It is like your money is losing the value it initially has.

The inflation rate is different in every country. Because of that the inflation rate is directly related to the exchange rate and vice versa. The exchange rate is the conversion of money from one currency to another. Usually, a country with a higher inflation rate has a lower value of currency and vice versa. That is if a country has a higher value of currency, it has more money compared to other country. In the unemployment case, the higher inflation rate creates a larger drive for people to get jobs which results to over supply on the job market, thus higher unemployment.

Likewise with lower unemployment rate which means people have enough purchasing power that results to lower inflation. Here I created a base point which is the inflation rate on how the terms underemployment, exchange rate and interest rates relate to each other. The relation between them can be seen on how it relates on the inflation. For example, a higher inflation rate dictates a higher interest rate, thus a lower exchange rate. For better discussion of the next topic, we will use the United States of America's economy as a basis or example. We had just discussed the unemployment rate.

Now we will find out its connection with the gross domestic product (GDP) based on the economy of the US. The GDP is a measure which usually equates to the status of the economy of the country. The GDP is basically computed as the grand total of how much everybody earn in the country for certain period of time. Obviously, lower unemployment results to higher GDP. As for the US economy, records show that the years with highest GDP is the year with the lowest unemployment. The GDP rises as more people are employed by different companies investing in the US.

These people greatly increase their productivity and in return increases the overall productivity of the country. According to Financial Forecast Center (2009), the GDP is expected to rise a little again as it took a hit during the last quarter of 2008 falling to about 14, 200. This recession is due to the rising unemployment in the US which was predicted by the Financial Forecast Center (2009) to rise over 10% this year. There are also other indicators that we measure and analyze the US's economy. These are the inflation rates and the interest rates.

According to reports of Craig Torres and Simon Kennedy of the Bloomberg News (2009), " the Federal Reserve may push interest rates below the pace of inflation this year". This will greatly affect the investments in the US because it could mean that households, banks and financial firms could be losing everyday. It will also affect the GDP since the current state of the interest slices earnings and expenses. As the interest rates go below the rate of inflation and if the government will allow it, it will result to greater inflation and lesser GDP for the country.

The real GDP will better explain the status of the US economy. It is because real GDP not only measures the output of the country. It also includes the price index in a specified time. The real GDP is basically the nominal GDP adjusted to the price index. It is just a more specific measure of the GDP. As we discuss the principles of macroeconomics, we must have a basic grasp of what is happening today. This is to teach you why things happen in a country's economy. And we must understand that even if these numbers indicates that the recession is over, it is not likely that you feel the effects of a better economy.

It is like when the US overcomes recession after the war. It took years or even a decade before we felt the effects of a better economy. References

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