Economic fluctuation in the short run economics essay

Short-Run Economic Fluctuations will never be missed in each country. Before that, there are three key-facts about Economic Fluctuations. Firstly, Short-Run Economic Fluctuations are always uneven and also largely indeterminable. Fluctuations in the economy are usually called the business cycle where it is equals to the changes in business condition. The usage of the term business cycle is lead astray because it says that Economic Fluctuations follow predictable model. Unfortunately, Economic Fluctuations are not constantly the same.

Second, most macroeconomic quantities, they fluctuate together because most of the macroeconomic variables that measure out some type of earning or production fluctuate near together. If the macroeconomic variables fluctuate together, they fluctuate with variant quantity. For example, if the economy is getting worse, they will reduce the amount of spending in houses, inventories and their demands.

Next, the other key-fact about the Economic Fluctuation is, as the output drops, the unemployment rate will rise. For example, if the firms are deducting their production on producing more goods and services to producing smaller quantity of goods and services, they will eventually lay off their workers to cut off their spending. Therefore, the unemployment rate will rise. The below graph shows the unemployment rate of a country.

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Figure Graph of an Unemployment Rate

The graph shows the Unemployment Rate of the country US between 1994 until 2012. As you can see, the unemployment rate will never be near to zero and it also fluctuates around its average natural rate.

For the Basic Model of Economic Fluctuations, the Economists usually apply the model of Aggregate Demand (AD) and also Aggregate Supply (AS) to easily explain the Short-Run Economic Fluctuations in the economic along the long-run course. Next, the Economists also apply the model of Aggregate Demand (AD) and Aggregate Supply (AS) to do the analyzation of Economic Fluctuation. As you can see at the graph below, the X-Axis is the economy's total output of overall goods and services. As at the Y-Axis, it is the level of price level.

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Figure – Aggregate Supply and Aggregate Demand Graph

As the result of this graph, the intersection point between the Aggregate Demand Curve, Short-run Aggregate Supply Curve and also the Long-Run Aggregate Demand (LRAD) Curve will give out the equilibrium output and also the equilibrium price level.

Aggregate Demand (AD) Curve

The Aggregate Demand Curve will show the demanded quantity of goods and services that the firms or the government want to buy at any price level. Based on the below graph (Figure 3), the economy's overall price level drop (from P1 to P2) which eventually will cause the increase of the quantity demanded goods and services (from Y1 to Y2).

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Figure – Aggregate Demand (AD) Curve

Next, the Aggregate Demand Curve will slopes downward because of the formula Gross Domestic Product (GDP) which is Y is equal to Consumption (C) + Investment (I) + Government Purchases (G) + Net Exports (NX).

The Aggregate Demand Curve usually rises when the price level go down. It is mainly because of these three effects which is the Wealth Effect, Interest-Rate Effect and also the Exchange-Rate Effect. Wealth Effect is the changes in value of assets and the increase in the market value of assets. For the Interest-Rate Effect, the interest rates will fall and will stimulate the demand of the investments goods and services. Interest rates are mainly used for the cost of borrowing money and the changes in this cost will show the effect on the aggregate demand curve. Furthermore, for the Exchange-Rate Effect, the currency will be under value and it will encourage the demand of net exports.

Aggregate Supply Curve

There are two types of Aggregate Supply Curve. One of it is the Long-Run Aggregate Supply curve. The curve is vertical because the changes of price level will not affect the long-run cause of the real Gross Domestic Products(GDP). Moreover, another example of Aggregate Supply Curve is the Short-Run Aggregate Supply Curve(SRAS). Short-Run Aggregate Supply Curve will slope upwards because of several theories.

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Figure – Short-Run Aggregate Demand Curve

The first theory is the Sticky-Wage Theory. Sticky-Wage Theory is because of the price level that increase and it will cause the firms or the government to hire fewer workers and lesser employments. This will definitely reduce the amount of goods and services production which may lead to lower Real GDP or output. The next theory is the Sticky-Price Theory. The Sticky-Price Theory is the price of some goods and also services that need to be adjusted in response of the changes happened in the economic situation. In addition, the other theory is the Misperception Theory. It is changes in overall price level and it will lead astray the suppliers or the sellers in selling their output and this will cause the suppliers to deduct the quantity of goods and services.

Two Causes of Short-Run Economic Fluctuation

Shifts in Aggregate Demand (AD)

Firstly, the changes in Aggregate Demand (AD) such as the increase of it or the decrease of it will make the Aggregate Demand (AD) Curve to shift. The increase of spending of the four categories which is the business, household, government and also the foreign will eventually make the Aggregate Demand (AD) Curve to shift to the right. But when the spending of the four categories decrease, it will make the Aggregate Demand (AD) Curve to shift left.

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Figure – Graph of Shifts in Aggregate Demand (AD) Curve

However, there are several factors that can cause the Aggregate Demand (AD) Curve to be shift to the right or to the left. First is the Exchange Rate of a country. For example if the country’s exchange rate is high or has increased, the Net Exports (Export minus the Import) will decrease. This also means that the Aggregate Demand Curve will also decrease. Other than that, if a country’s is having a recession, it will also decrease the country’s Net Exports which will make the Aggregate Demand (AD) Curve to shift to the left side. Unfortunately, when it heals back from the recession, therefore the Aggregate Demand (AD) Curve will shift back to the right side. Other than that, the exchange rate of a country can also be one of the factors of it. As the simple example, a country increases the value of their country’s currency in the foreign exchange market. This will make the country’s goods and services to be more expensive than the others. Therefore the Net Exports will be depressed and will move the Aggregate Demand (AD) Curve.

Next is the Investments, where the people or firms will invest more if the money supply goes up, this will shift the Aggregate Demand (AD) Curve to the right. Next is when the people will invest lesser or cut their investments because of the decrease of money supply which will shift the Aggregate Demand (AD) Curve to the left.

In addition, it is the shifting of the consumption that always changes. It is mainly because of the citizens that realize to be more saving for the future purposes and finally they will reduce their consumption. Therefore the Aggregate Demand (AD) Curve will move to the left. Different from the other one, if the people real wages increased or gain profits, they will consume more and will increase the amount of goods and services demanded, therefore the Aggregate Demand (AD) Curve will move to the right.

Shifts in Short-Run Aggregate Supply (SRAS)

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Figure – Graph of Shifts in Short-Run Aggregate Supply (SRAS) Curve

There are also several factors that can cause the Short-Run Aggregate Supply or mostly known as ‘ SRAS’ to shift. First is about the changes in unit labor cost which can cause the curve to shift to the right because of the natural rate of unemployment. The curve will shift to the left due to the decrease in amount of labor because of the firms paying higher wages.

Next is the change of price of raw materials or natural resources that is mostly need for production such as oil, iron, aluminum and rubber. The price of the imported goods, for example is the tariff that is applied to imports or also the quota of imports things that has increased will raise the supply available. This is due to the exchange rate of a country with the foreign country, it can cause price of the imported goods such as the raw materials to be fluctuated.

Without exception, shift because of modern technology where the knowledge of latest technologies and with the advance technologies achieved by the country will make things produced with cheaper price. Therefore it will move the curve to the right. But if the country is lack of modern technology due to the rules and regulations of the country or any other reason, the Short-Run

Aggregate Supply Curve can shift to the left because it will cost them higher price to produce goods and services.

Task 2

The recession can be seen in Spain during the 2008 and 2009. Recession means the economic growth drop two consecutive quarters. As the aggregate short run demand goes to the left it will produce recession. GDP in Spain began to fall in 2008 to 2009, this make six consecutive quarters GDP rate drop. The Growth Domestic Product has a relationship with the government debt and Spain government debt was below the European Union average. In 2007 Spain debt compare with Euro zone average is the lowest of all time.

File: Spanish debt and EU average. pngHistorical Data Chart

Property Market

The Spanish Property Market collapse causes recession. The house prices fell to 11. 2% in the prices of used homes was down 13. 7% and also the mortgages biggest drop down 25%. The reading is the worst countrywide of all time. The Spanish property prices are similar as United State after the 2008 financial crisis. This problem was supported by the government and banks. Private sectors example companies taking the loans out cause interest rate decreases. Interest rate goes down, the prices also go down so that people borrow more money to buy housing and that’s help the investment to grow up.

[specon]

Trade

The recession also cause by Spain weak trade because the increases reliance on imported petrol. Trade means a lot to Spain because half of the Gross Domestic Product is from trade. Spain trade had tripled the time from 2002 to 2008. Spain major trade is from the country example Germany, France, Portugal and Italy. In 2009 Spain has trade deficit according to the central intelligence agency. Spain faces problem in competitive price disadvantage so less competitive hard to export product to other country. Spain export and import partners are from the European Zone region. Spain export normally is vehicles and medicines. During 2009, imports values are at $293. 2 billion which drop the value $415. 5 from 2008. The gap between Spain’s export and import are big the main reason is lack of resources in the country.

Historical Data Chart

Inflation Rate

The inflation rate falls in 2009. Inflation fall means economy got problem because Spain unemployment rate will rise and this cannot be solved faster. On the hand, reduce of currency can help to recover competitiveness and export help to solve the crisis. This is the only chance that Spain can get off recession, European scared the inflation to drop that affect the fuels. Deflation causes the drugs fell 0. 7 percent and also decline in clothing and prices for electronics. According to the National Statistics Institute, year to year the rate fell 0. 9 percentage in December, the fifth consecutive monthly drop.

Historical Data Chart

Recession in a country are caused by economic fluctuation. Recession have cause a lot of impacts on the citizens' daily life and of course the economy. Recession impact a country in a social sense, financially and economically. In this case, the recession that happened in Spain led to these three

impacts.

Firstly the financial effects of recession in Spain. Spain had problems in the property section especially the real estate. There was 200% rise in in real estate prices from 1996 to 2007. In 2004, 509, 293 new properties were built in Spain and in 2005 the number of new properties built was 528, 754. Of all the houses built, over 28% were vacant in late 2008. Spain became one of the worst affected countries compared to other countries when the speculative bubble was revealed. Eurostat revealed that Spain was the European country with the sharpest plunge in construction rates over the June 2007-2008 period.

Spanish house prices drop greatly at the first three months of 2012. This aggravated the country's already severe problems with the housing market. National Statistics Institute INE reported in its House Price Index that property values dropped by 12. 6% as compared to 2011.

In some coastal resorts, there are 70% reduction in house prices in the last 5 years as the people struggle to sell their properties . So many people trying to sell properties but ended up letting them go for a fraction of what they offered initially.

Spain have billions of euros of debts relating to the property sector and also extremely high unemployment rates. Banks will borrow $100 billion euro for Spanish Government to resolve the issue. However, banks' uncertainty led to mortgage deals for new seeker for a new property drop fast. Mortgage lending suffered the largest fall in over six years in early 2012 reports have stated. A further 20% in house prices decline could still occur according to the International Monetary Fund (IMF).

During the crisis period, Spain had a public debt of 36. 2% of GDP. This was mostly down to the amplifying tax revenue from the housing bubble. This caused the government to increase their spending without debt accumulation.

Spain is edging towards a financial disaster and causes currency to tear apart as the Eurozone was back. Spain's huge economy was said to be at a ' tipping point' and would eventually require international aid.

Spain need a loan from the International Monetary Fund as a result of this crisis. Having already the requirement for an emergency loan package from bank up to £80 billion Spain, this country is further hurt by enduring property crash and having an insane percentage of unemployment rate. Currently, Spain is paying debt for over six months. Sources said Spain would need a loan to prevent financial collapse.

Secondly, recession that happened in Spain caused economic problems most notably the severe unemployment problems in Spain. In October 2008, Spain saw its unemployment rates similar to 1996 levels. Spain had its unemployment rate climbing 37% from October 2007 to October 2008. At the end of March 2009, Spain’s unemployment rate hit 17. 4%with the total of the jobless doubled over the past 12 months, when two million people lost their jobs. Spain had the same number of jobless as France and Italy combined by July 2009.

Spain depend on the inter-generational family structure for a significant portion of the social safety net. The unemployment rate is 12. 4% less than the 25% overall rate. During the boom period, the underground economy can be found in employment which is estimated to be as large as 20% of the economy.

Spain’s banking crisis came to the fore in early May 2012, when Madrid nationalized one of the country’s largest lenders, Bankia, and then requested the banking bailout a month later. Bankia reported a loss of 2. 6 billion euros for the third quarter.

Challenges Madrid that how to value assets that Bankia and other troubled banks are set to transfer, which is meant to sequester tens of billions of euros of property loans and repossessed assets that carry the risk of never being repaid or sold. In setting up the bad bank, Madrid must perform a balancing act, one that proved Ireland’s undoing earlier in the European debt crisis. The challenge is to make such assets cheap enough to attract private investors without forcing the entire banking sector to make steep and immediate reductions in the value of their whole property portfolios.

Tourism make one-tenth of Spain’s economy, has also remained relatively buoyant, with Spain welcoming a record number of foreign visitors. A sigh of relieve in spain as Ford shut three factories in Europe, eliminating 5, 700 jobs,. The decision is to protects Ford's factory in Valencia, which will take over production from Gen. Overcome the unemployment problem like lowering the minimum wage or cutting unemployment benefits.

Lastly, the effect of recession towards the citizens in Spain . Recession effects socially can be seen clearly as whenever a country is in trouble, it will be the citizens who will suffer. When the economy is in trouble, inflation will occur and that will cause price increases that effect of the food consumption.

Spain's economic has been the one of the worst in Europe. Collapse of the housing industry and unemployment figures made consumers spend less. This also drives consumers to buy cheaper products. Private label now stands at around 38 per cent penetration. 30 per cent of Spanish consumers bought cheaper product because of the recession, according to the IRI's consumer survey while 17 per cent purchased cheaper soups. This shows the immediate effect towards the citizens as a result of recession. Though it seem like a small matter, it can aggravate over time

Spain is predicted to still be in recession in 2013. One quarter of the spaniards who is out of job is only expected to get worse. Middle class who is living a beggar-like life is the most noticeable situation that you can see in Spain's current state.

Many people who lined up at the food banks actually hold a degree, used to have a car, a stable life but were forced to change their way of life. People who just got out of job might just live normally with their savings. It is when they reach the second year they will usually come to realize they need all the help they can get.

What recession can also affect is the happiness of the citizens and the next generations’ future. A teenager was quoted questioning how can he actually expect to live a normal life when his mother does not have money, even chasing his dreams might just not be the wisest things to do considering the economic situation which hardly guarantees a place in the workforce for even for the people with a degree. This fact is a very disturbing one.

Spaniards are generally very negative about their futures as a result of recession according to a survey carried out by the Pfizer Foundation. This really affect their daily lives and well being. A survey was made with 1200 people, almost half of them feared that they might lose their job in the future.

Over a quarter of the people surveyed stated that their life quality had gone down while almost half questioned admit to be having so much stress because of the recession. Some would go as far to stop filling their times with hobbies altogether. Earlier in 2012, 2 famous wealthy businessman was reported to have commited suicide. It was said that this was a direct result of recession as both man did that shortly after both of their companies went bankrupt.

However, most people do generally worry more about they having a job rather then their health. Further question revealed that three quarter eating habits have not been affected while over a quarter admitted they have their day to day shop habits need a big change. Task 4

There are 2 method can overcome the recession in Spain Monetary Policy and Fiscal Policy. Monetary Policy defined as a country control the money supply and target to the interest rate to stabilize the economic growth. As Fiscal Policy can be defined as government receive tax and government purchase that can affect the economy.

To resolve recession in monetary policy, one way to higher up the aggregate demand. The money supply increases, the interest rate decreases and affect the investment to grow so the aggregate demand increases. Example, the low interest rate in Spain sold the yield on the bond came in at 2. 835% from 3. 07%. The investment grows from the property while Spain base rate Euro is low and mortgage rate of 5%.

To resolve recession in fiscal policy,