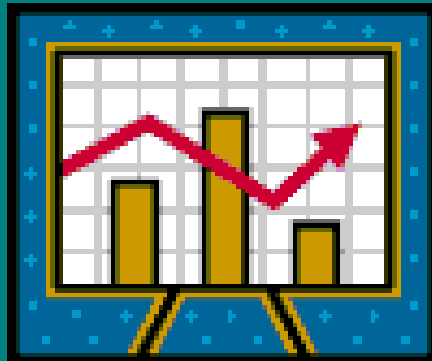


# MEASURING ECONOMIC PROGRESS

## Chapter 2



Chapter 2 -- Economic Activity  
Intro to Business

# MEASURING ECONOMIC ACTIVITY

- Economic Growth
  - Economic growth refers to a steady increase in production of goods and services in an economic system.
  - Different methods are used to measure our economic growth.
- Base Year
  - The year chosen to compare an item, such as price, to any other year.

# MEASURING ECONOMIC ACTIVITY

- GROSS DOMESTIC PRODUCT (GDP)
  - The total dollar value of all final goods and services produced in a country during one year.
- GDP Per Capita
  - The output per person
  - Per capita output is found by dividing GDP by the total population

# MEASURING ECONOMIC ACTIVITY

- Components of GDP
  - Consumer spending – food, clothing, housing & other spending
  - Business spending for buildings, equipment, and inventory items.
  - Government spending to pay employees and to buy supplies and other goods and services.
  - The exports of a country less the imports into the country.

# MEASURING ECONOMIC ACTIVITY

- Labor Activity
  - Employment
    - Labor force: consists of all people above age 16 who are actively working or seeking work.
    - The unemployment rate is the portion of people in the labor force who are not working
      - people who are looking for work and willing to work, but unable to find a job
      - Unemployment rates vary from year to year
      - The main cause of unemployment is reduced demand for the goods and services being provided by various workers

# MEASURING ECONOMIC ACTIVITY

- Labor Activity
  - Productivity
    - Measured in terms of the number of items produced per worker
    - An increase in output per worker is an important source of economic growth
    - Improvements in the quality of capital resources (primarily equipment), worker training, and management techniques have resulted in more output from the same number of workers – this increase is called productivity increase

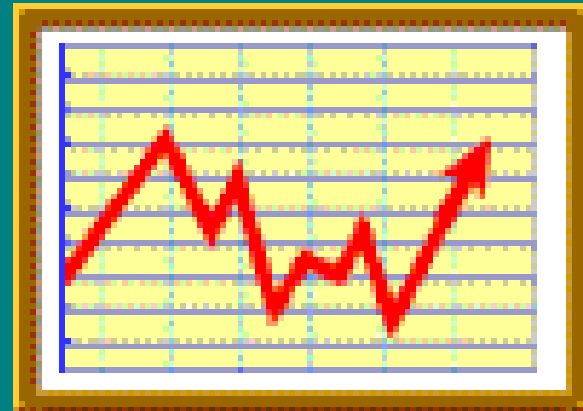
# MEASURING ECONOMIC ACTIVITY

- Consumer Spending
  - Personal Income
    - Salaries and wages
    - Investments
    - Government payments to individuals
  - Retail Sales
    - The sales of durable and nondurable goods bought by consumers
    - The main items measured for estimating retail sales include automobiles, building materials, furniture, gasoline, and clothing, as well as purchases from restaurants, department stores, food stores, and drug stores

# ECONOMIC CONDITIONS CHANGE

## The Business Cycle

- THE BUSINESS CYCLE
  - The movement of the economy from one condition to another and back again.
  - The recurring ups and downs of GDP.
  - There are four phases:
    - Prosperity
    - Recession
    - Depression
    - Recovery



# ECONOMIC CONDITIONS CHANGE

## The Business Cycle

- Prosperity
  - At the high point of the business cycle
  - During prosperous times, most people who want to work are working
  - Wages are good
  - GNP is high
  - Consumers are buying and business is booming



# ECONOMIC CONDITIONS CHANGE

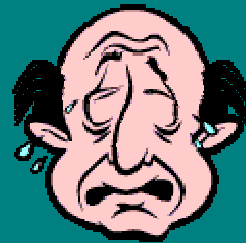
## The Business Cycle

- Recession
  - The point in the business cycle when demand falls and businesses lower production
  - Unemployment begins to rise
  - It may not be too serious or last very long but may signal trouble for some groups of workers in related businesses – *the ripple effect*

# ECONOMIC CONDITIONS CHANGE

## The Business Cycle

- Depression
  - If a recession deepens and spreads through the entire the nation may move into a depression
  - This phase is marked by high unemployment and business failure
  - GNP is at its lowest point during a depression



# ECONOMIC CONDITIONS CHANGE

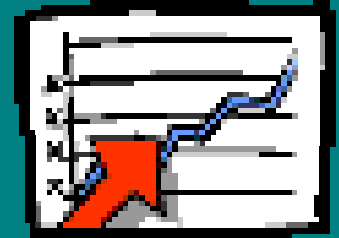
## The Business Cycle

- Recovery
  - The phase in which unemployment begins to decrease and GNP rises
  - People begin to find jobs
  - Consumers regain confidence about their futures and begin buying again



# ECONOMIC CONDITIONS CHANGE

## Consumer Prices



- Inflation
  - An increase in the general price level
  - In times of inflation, the buying power of the dollar decreases
    - If prices increased 5 percent during the last year, items that cost \$100 then would now cost \$105 – it now takes more money to buy the same amount of goods and services
  - Inflation is most harmful to people living on fixed incomes – due to inflation, retired people and others whose incomes do not change are able to afford fewer goods and services

# ECONOMIC CONDITIONS CHANGE

## Consumer Prices

- Causes of Inflation
  - When the demand for goods and services is greater than supply
  - When a large supply of money, earned or borrowed, is spent for goods that are in short supply, prices increase
  - Even though wages tend to increase during inflation, prices of goods and services usually rise so fast that the wage earner never seems to catch up
  - Workers have to earn more money to maintain the same standard of living during inflation
  - Producers may receive higher prices for the goods and services they sell, but if wages go up faster than prices, businesses tend to hire fewer workers and so unemployment worsens

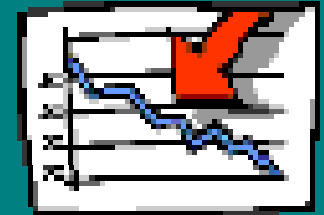
# ECONOMIC CONDITIONS CHANGE

## Consumer Prices

- Measuring Inflation
  - Mild inflation – 2 to 3 percent a year -- can actually stimulate economic growth
    - Wages often rise more slowly than prices of products
    - The prices of products sold are high in relation to the cost of labor
    - The producer makes higher profits and tends to expand production and hire more people
    - Newly employed workers increase spending, and the total demand in the economy increases
  - Price Index –
    - A price index is a number that compares prices in one year with some earlier base year
    - Consumer Price Index (CPI) is based on a group of selected items
      - Many people face hidden inflation since they may not buy the exact items used to calculate the index

# ECONOMIC CONDITIONS CHANGE

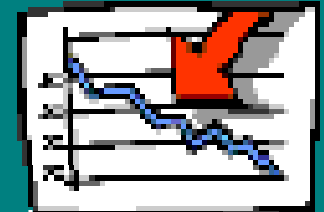
## Consumer Prices



- Deflation
  - A decrease in the general level of prices.
  - Usually occurs in periods of recession and depression
  - Prices of products are lower, but people have less money to buy them
  - Significant deflation occurred in the United States during the Great Depression of the 1930s. Between 1929 and 1933, prices declined about 25 percent

# ECONOMIC CONDITIONS CHANGE

## Interest Rates



- Interest rates represent the cost of money
- Have a strong influence on business activities
  - Companies and governments that borrow money are affected by interest rates
  - Higher interest rates mean higher business costs
- Consumers are affected by interest rates
  - Earning you receive as a saver or an investor
  - Borrowers are affected – people with poor credit ratings pay a higher interest rate than people with good credit ratings
- Changing Interest Rates
  - Each day the cost of money – *interest* – changes because of various factors
    - Supply and demand for money
    - As amounts saved increase, interests rates tend to decline – because there are more funds available
    - When borrowing increases, interest rates are likely to rise

# ECONOMIC CONDITIONS CHANGE

## Interest Rates

- Types of Interest Rates
  - prime rate
    - rate banks make available to their best (commercial) customers
  - discount rate
    - the rate financial institutions are charged to borrow funds from Federal Reserve banks
  - T-Bill rate
    - the yield on short-term (13-week) U.S government debt obligations
  - treasury bond rate
    - the yield on long-term (20-year) U.S government debt obligations
  - mortgage rate
    - the amount individuals pay to borrow for the purchase of a new home
  - corporate bond rate
    - the cost of borrowing for large U.S. corporations
  - certificate of deposit rate
    - the rate for six-month time deposits at savings institutions

# OTHER MEASURES OF BUSINESS ACTIVITY

- **Investment Activities**

- **Capital Spending**

- Refers to money spent by a business for an item that will be used over a long period
    - Capital projects involve spending by businesses for items such as land, buildings, equipment, and new products
    - Money for capital projects comes from three main sources: personal savings, stock investments, and bonds

- **Personal Savings**

- Financial institutions use money you deposit and pay interest on this money
    - The savings of a country is an important factor for economic growth

- **The Stock Market**

- Stock represents ownership in corporations – *equity*
    - The value of stock is affected by many factors; supply and demand.

- **The Bond Market**

- A bond represents *debt* for an organization
    - When you buy a bond, you are a creditor

# OTHER MEASURES OF BUSINESS ACTIVITY

- Borrowing
  - Government Debt
    - Government provides services, which cost money
    - Budget Surplus – *when you spend less than you take in*
    - Budget Deficit – *when you spend more than you take in*
    - National Debt – *the total amount owed by the federal government*

# OTHER MEASURES OF BUSINESS ACTIVITY

- Borrowing
  - Business Debt
    - Loans, bonds, and mortgages
    - Efficient use of borrowing can be helpful to companies – *expand sales and profits*
  - Consumer Debt
    - Credit cards, auto loans, and home mortgages
    - Use of credit can be convenient
    - Unwise use of credit can result in legal action and other trouble

# OTHER MEASURES OF BUSINESS ACTIVITY

- Future Economic Challenges
  - Developing New Technologies
  - Inadequate Health Care
  - Inadequate Housing
  - Traffic and Crime
  - Unemployment