

THE BUSINESS CYCLE AND UNEMPLOYMENT

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AP MACROECONOMICS

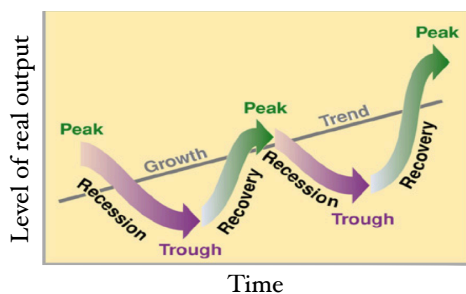
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The Business Cycle

- * The United States' GDP is not constant from year to year.
- * Instead, the GDP grows most years and then shrinks in some years.
- * The ups and downs in GDP over time is referred to as the business cycle.

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The Business Cycle Illustrated:



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The Business Cycle Illustrated:

- * Peak
 - * Temporary maximum in Real GDP. At this point the unemployment rate ($u\%$) is probably below the natural rate of unemployment, and the inflation rate ($\pi\%$) is probably increasing.
- * Recession
 - * The contractionary phase of the business cycle. A period of decline in Real GDP accompanied by an increase in $u\%$. To be classified as a recession, the economic decline must be at least 6 months long.

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The Business Cycle Illustrated:

- * Trough
 - * The bottom of the business cycle. The $u\%$ is probably high and $\pi\%$ is probably low.
- * Recovery
 - * The phase of the business cycle where the economy is returning to full employment.

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The Business Cycle Illustrated:

- * Important Note
 - * The various phases of the business cycle last for different amounts of time.
 - * In recent history, expansions have lasted years longer than have recessions.
 - * The Great Depression is the most notable example of a long recession/trough

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The Business Cycle Illustrated:

- * Causes
 - * Irregularity of Investment
 - * Changes in productivity
 - * Changes in total spending (aggregate demand)
- * Durable goods manufacturing is most susceptible to the effects of the business cycle
- * Business cycle has become less severe because of technological advancements in supply-chain management and structural changes in U.S. economy.

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Measuring Unemployment

- * Population
 - * Number of people in a country
- * Labor Force
 - * Number of people in a country that are classified as either employed or unemployed
 - * Labor Force Participation Rate
 - * % of working age population in the labor force (U.S. is approx 66%)

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Measuring Unemployment

- * Employed
 - * People 16 years and older that have a job.
 - * It doesn't matter if it's part-time or full-time, as long as they work at least 1 hour every 2 weeks
- * Unemployed
 - * People 16 years and older that don't have a job, but have actively searched for a job in the last 2 weeks
 - * $\text{Unemployment rate} = \frac{\# \text{ of unemployed}}{\# \text{ of people in labor force}}$
- * Not in Labor Force
 - * Kids, military personnel, retired people, stay at home Moms and Dads, full-time students, your 40 year old uncle who sleeps on the couch all day, most of the homeless.

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Types of Unemployment

- * Frictional
 - * "between jobs", voluntary, good for individuals and society
- * Structural
 - * Associated with lack of skills or declining industry (ex. High school dropouts, type-writer repairmen). Think "Creative Destruction"

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Types of Unemployment

- * Cyclical
 - * Associated with downturns in business cycle. Bad for society and individuals.
- * Seasonal
 - * Mall Santas, Schlitterbahn Life-guards, Ride operators at Fiesta Texas, Golf-pros in Alaska during January.

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Current Unemployment

(not asked on AP test, just for reference)

- * 9.6% August 2010 (US Dept of Labor)
- * 7.7% February 2013 (US Dept of Labor)

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Full Employment

- * Occurs when there is no cyclical unemployment present in the economy
- * Associate with the Natural Rate of Unemployment (NRU).
 - * The level of unemployment experienced when the economy is producing at its full potential.
 - * The United States' NRU is approx. 4%-5%
- * Associate Full Employment (FE) with the PPC, the long-run aggregate supply (LRAS) and the long-run Phillips curve (LRPC)

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Why is Unemployment bad?

- * Okun's Law- Every 1% increase in the u% causes a 2% decline in Real GDP.
- * The burden of unemployment is not equally shared in society.
- * It causes social unrest and is hard on individuals and families.

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