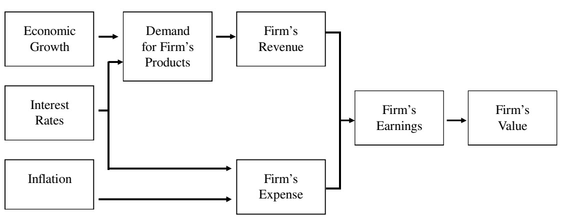
Chapter 3

Assessing Economic Conditions

Learning Objectives

❶ Identify the macroeconomic factors that affect business performance.
❷ Explain how market prices are determined.
❸ Explain how government influences economic conditions.

Economics and the Value of Business



Economics

☑ **Macroeconomic Conditions:**
- Reflect the overall U.S. economy.

☑ **Microeconomic Conditions:**
- Focus on the business or industry of concern.

Macroeconomic Factors Affecting Business Performance

❶ Economic Growth.
❷ Inflation.
❸ Interest Rates.

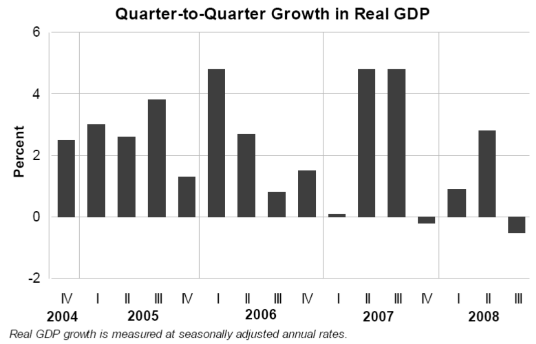
Three Measures of Economic Growth

① Total production level of products and services:
- GDP is the total market value of all final products and services produced domestically.

② Total aggregate expenditures:
- Total amount of expenditures in the economy.

③ Alternative economic indicator:
- Unemployment level.

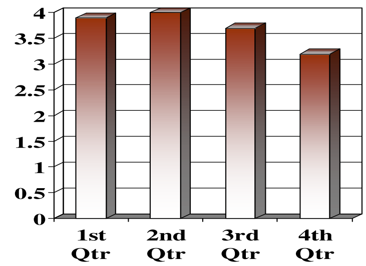
Gross Domestic Product (GDP)



Source: www.bea.gov

Recession

- Negative growth as measured by the GDP for two consecutive quarters.



Four Types of Unemployment

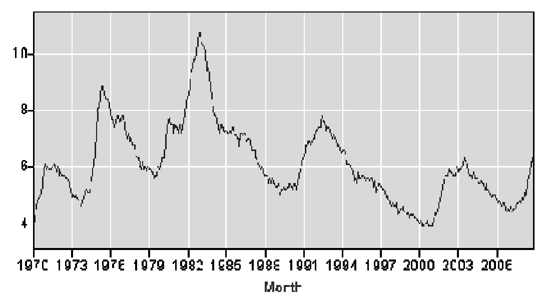
① **Frictional unemployment**
- People who are between jobs.
- Also referred to as natural unemployment.

② **Seasonal unemployment**
- People whose services are not needed during some seasons.

③ **Cyclical unemployment**
- Unemployed due to poor economic conditions.
- Probably the best indicator of economic conditions.

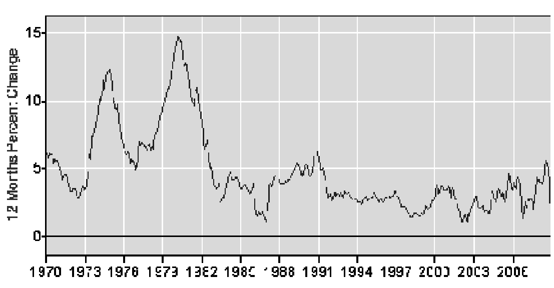
④ **Structural unemployment**
- Unemployed due to inadequate work skills.

U.S. Unemployment Trends



Source: www.bls.gov - Series Id: LNS14000000

U.S. Inflation Over Time



Source: www.bls.gov - Series Id: CUUR0000SA0

Macroeconomic Factor: Inflation

Inflation: increase in the general level of prices of products and services over a specific period of time.

Firms are affected by:

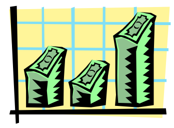
- Higher costs of operation.
- Higher wages paid to employees.
- Higher revenues.

Two Types of Inflation

❶ Cost-push inflation
- Higher prices charged by firms are caused by higher costs.

❷ Demand-pull inflation
- Higher prices due to stronger consumer demand for products.

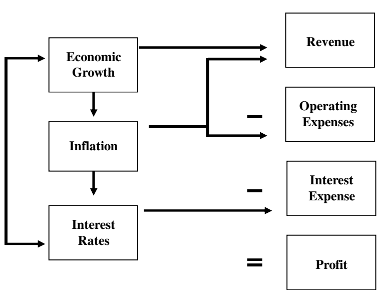
Interest Rate: Cost of Borrowing Money



Firms are affected by:

- Higher interest expense .
- Lower return on investment.
- Lower degree of expansion.

Macroeconomic Factors Affecting a Firm's Profits



Determining Market Prices

- Demand schedule
  - Indicates the quantity of a product that would be purchased at given prices.
- Supply schedule
  - Indicates the quantity of a product that would be supplied at given prices.
- Interaction of supply and demand
  - Equilibrium price: price at which quantity supplied equals quantity demanded.

Demand Schedule Changes May Cause

- Quantity demanded to increase or decrease.
- Equilibrium price to increase or decrease.

Example: Computers become very popular, causing demand to increase.

Supply Schedule Changes May Cause

- Quantity supplied to increase or decrease.
- Equilibrium price to increase or decrease.

Example: Technology allows firms to produce computers at a lower cost, so firms are willing to supply more at a lower price.

Factors that Influence Market Pricing

① Consumer Income.
② Consumer Preferences.
③ Production Expenses.

Two Government Policies that Influence the Economy

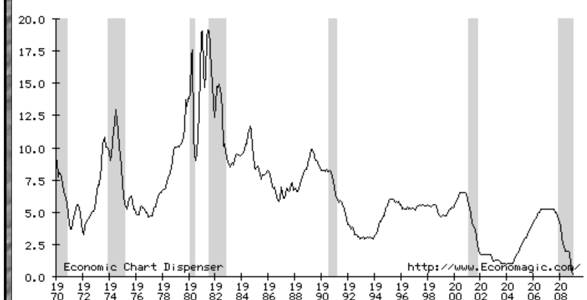
➲ <u>Monetary Policy:</u>
- Control U.S. money supply.
- The Federal Reserve sets the policy.
- Increase or decrease interest rates has major implications.

➲ <u>Fiscal Policy:</u>
- Control taxes and spending.

Factors Affecting Interest Rates

❶ Monetary Policy.
❷ Economic Growth.
❸ Expected Inflation.

Federal Reserve Rate Trends



Source: www.economagic.com

Fiscal Policy Decisions For Revising

- Personal tax rates.
- Corporate taxes.
- Excise taxes.
- Budget deficit.