Chapter 3
Assessing Economic Conditions

Learning Objectives

1. Identify the macroeconomic factors that affect business performance.
2. Explain how market prices are determined.
3. 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

- Economic Growth.
- Inflation.
- 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)

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

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

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

2. 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

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

- **Fiscal Policy:**
  - Control taxes and spending.

Factors Affecting Interest Rates

- 1. Monetary Policy.
- 2. Economic Growth.
- 3. Expected Inflation.

Federal Reserve Rate Trends

Source: www.economagic.com

Fiscal Policy Decisions For Revising

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