

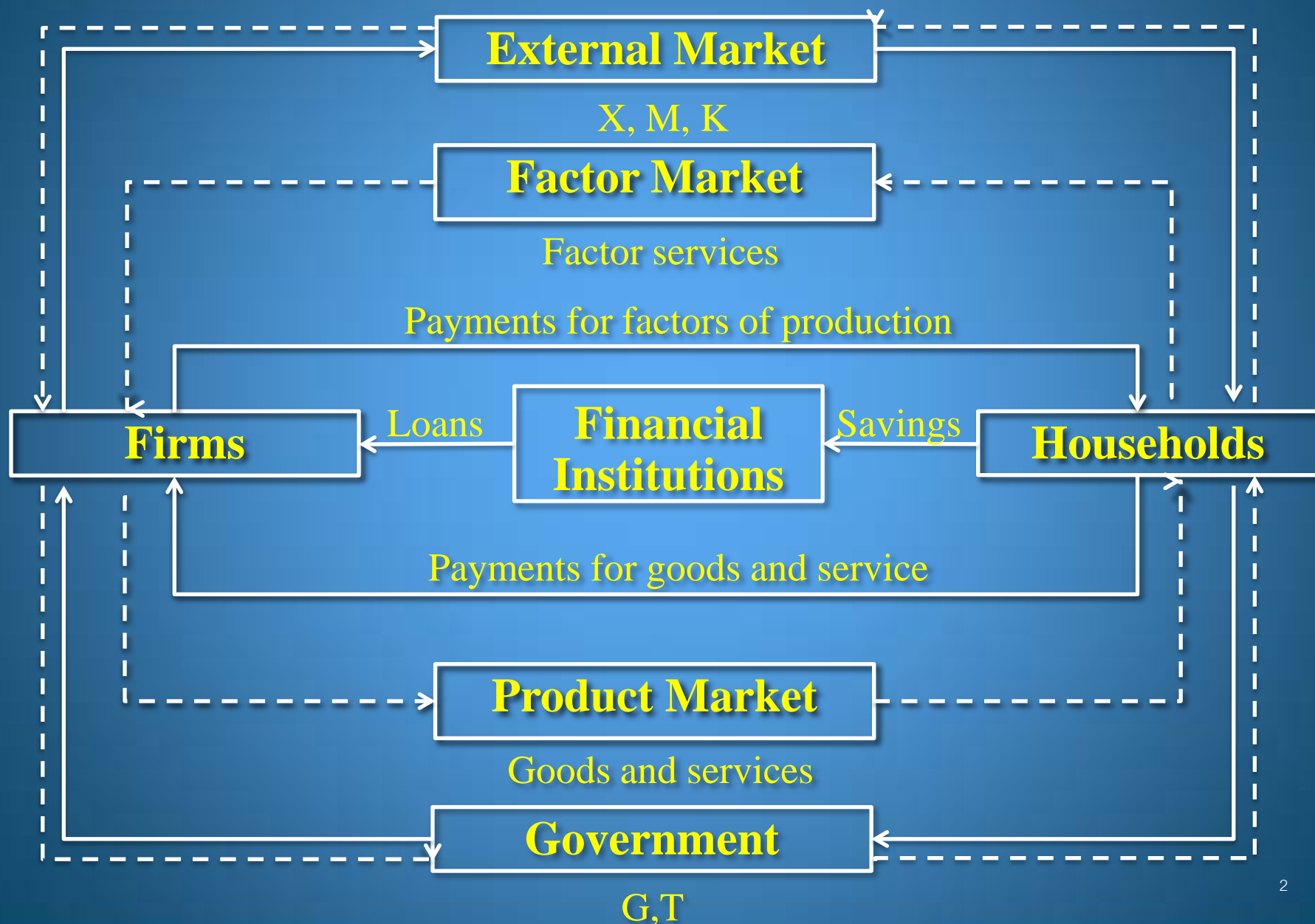
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EE 312: Macroeconomics Theory

Introduction and Simple Macro Model

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The circular flow of incomes and expenditures



Major macroeconomic institutions

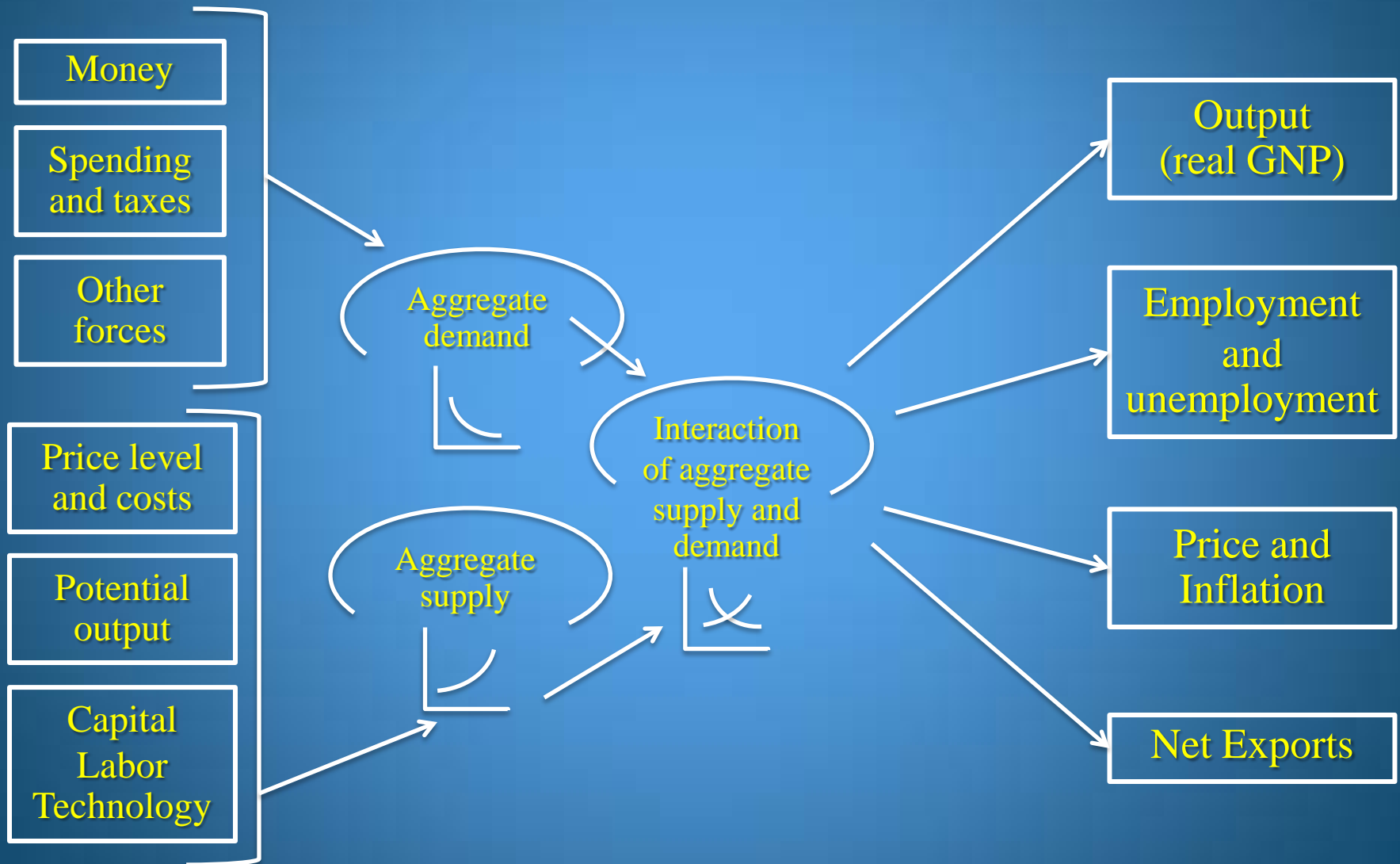
1. Household
2. Firm (or Business Sector)
3. Financial Institutions
4. Government sector
5. Foreign Countries

Major markets under macroeconomic analysis

1. Goods or Product market
2. Money market
3. Factor market
4. Foreign Market

(Exports, Imports, Capital Flows, Foreign Exchange, Balance of Payment)

Interaction of AD and AS determines the major macroeconomic variables



Macroeconomic Objectives

1. Full employment
2. Economic growth
3. Price Stability
4. External balance
5. For developing country: reduction of poverty and income inequality

Hypothetical distribution of income

Person	Distribution of Income		Growth rate (%)
	Year 1	Year 2	
1	100	120	20
2	0	0	0
3	0	0	0
4	0	0	0
5	0	0	0
6	0	0	0
7	0	0	0
8	0	0	0
9	0	0	0
10	0	0	0
Total Income	100	120	20
Average Income per head	10	12	20

Review of simple macro model

Equilibrium Condition: Closed economy

$$Y = C + I + G$$

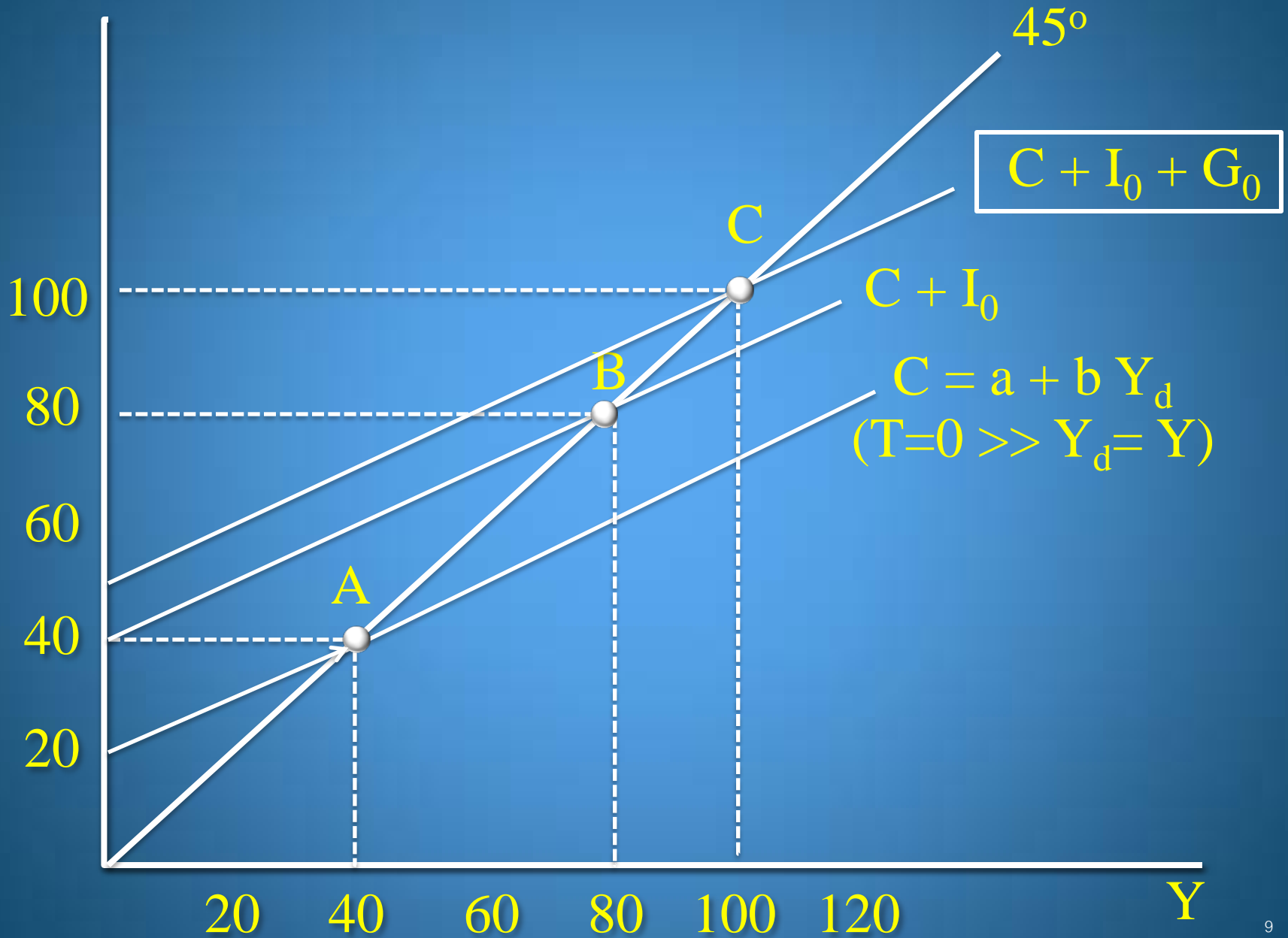
Assumptions: $I_0 = 20$

$$G_0 = 10$$

$$T_0 = 0$$

$$C = 20 + 0.5Y_d$$

C, I, G



Disequilibrium

(a) If $Y = 90$;

$$C + I + G = 20 + 0.5(90) + 20 + 10 = 95$$

Aggregate Demand (=95) > Aggregate Supply(=90)

(b) If $Y = 120$;

$$C + I + G = 20 + 0.5(120) + 20 + 10 = 110$$

Aggregate Supply (=120) > Aggregate Demand(=110)

(c) Adjustment to equilibrium

Schools of thought

- Classical Model
- Keynesian model
- The Monetarist
- New Classical economics
- Real Business Cycle model
- New Keynesian Economics