

# 2

## chapter

# Economics and Banking

*Better Business*

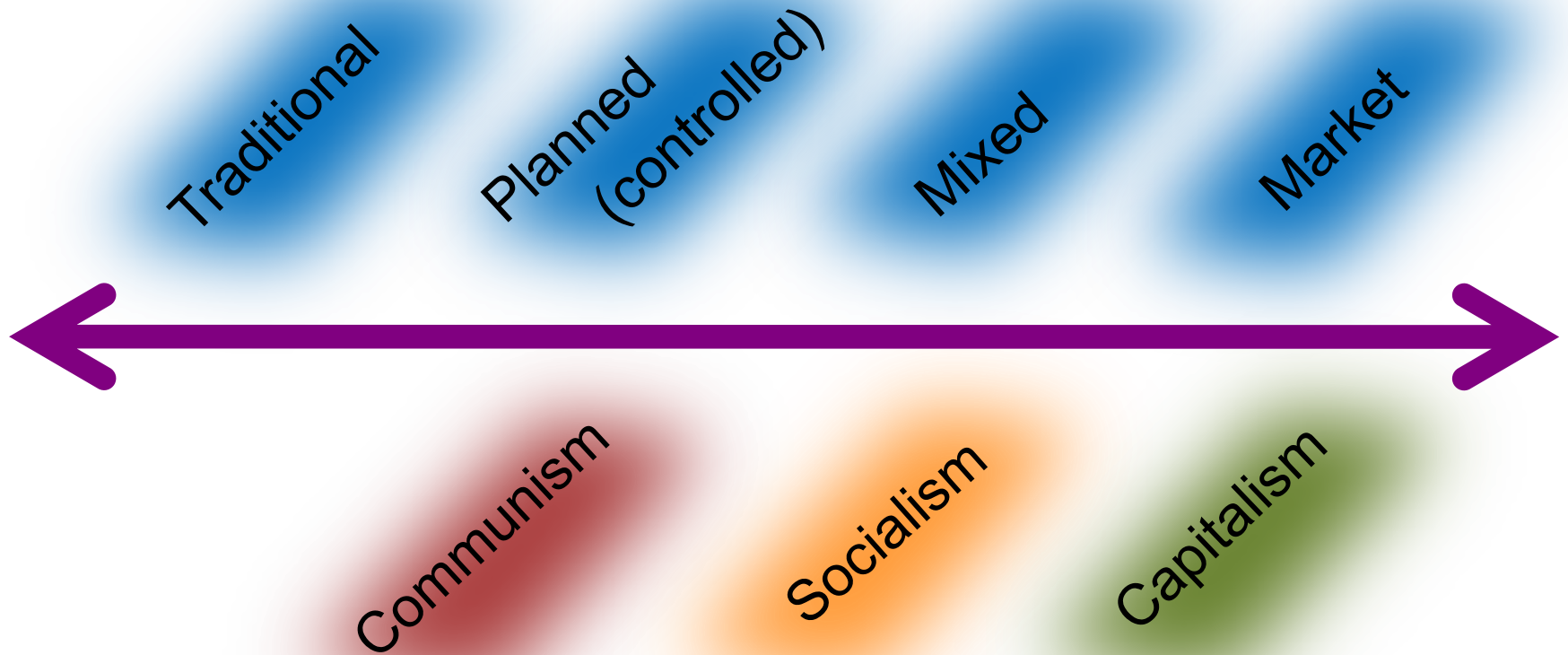
Solomon (Contributing Editor) •  
Poatsy • Martin

# Economics Basics

- Supply and demand
  - determine how goods and services are priced
- Microeconomics
  - study of individual purchase decisions
- Macroeconomics
  - study of behavior of the overall economy

*Why do business managers need to be concerned with economics?*

# Types of Economic Systems



# Economic Systems: Related Ideas

- Privatization

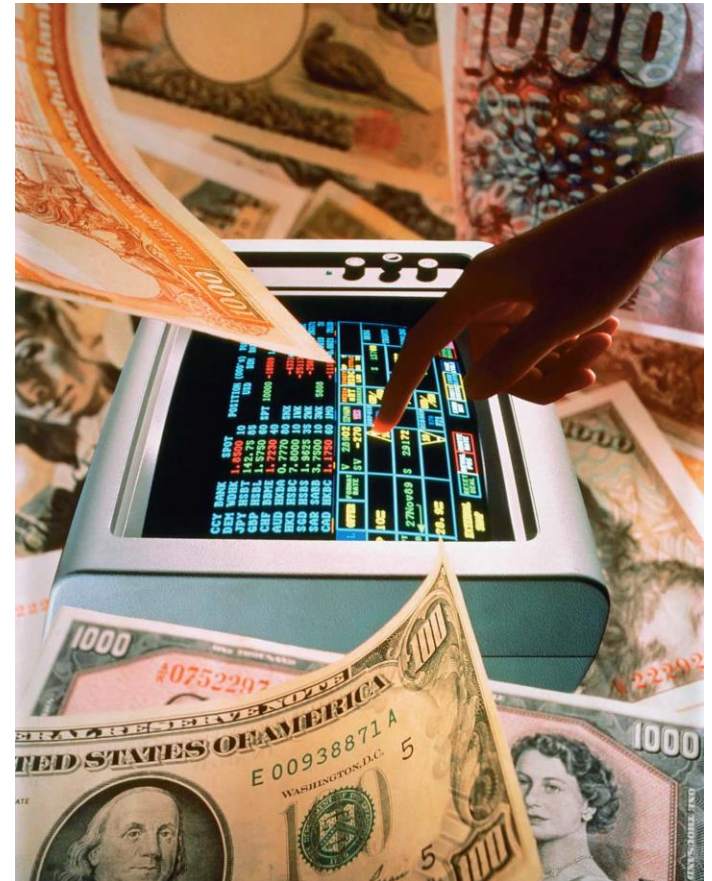
- conversion of government production and services to privately-owned, profit-seeking enterprises

- privatization possibilities: water, utilities, transportation, other

**Generally, privatization moves an economic system from \_\_\_\_\_ to \_\_\_\_\_.**

# Determining Price: Supply and Demand

- Currency
- Market price
  - price at which everyone who is interested can get an item with none left over
- Supply
  - availability of the item
- Demand
  - need or desire for the item

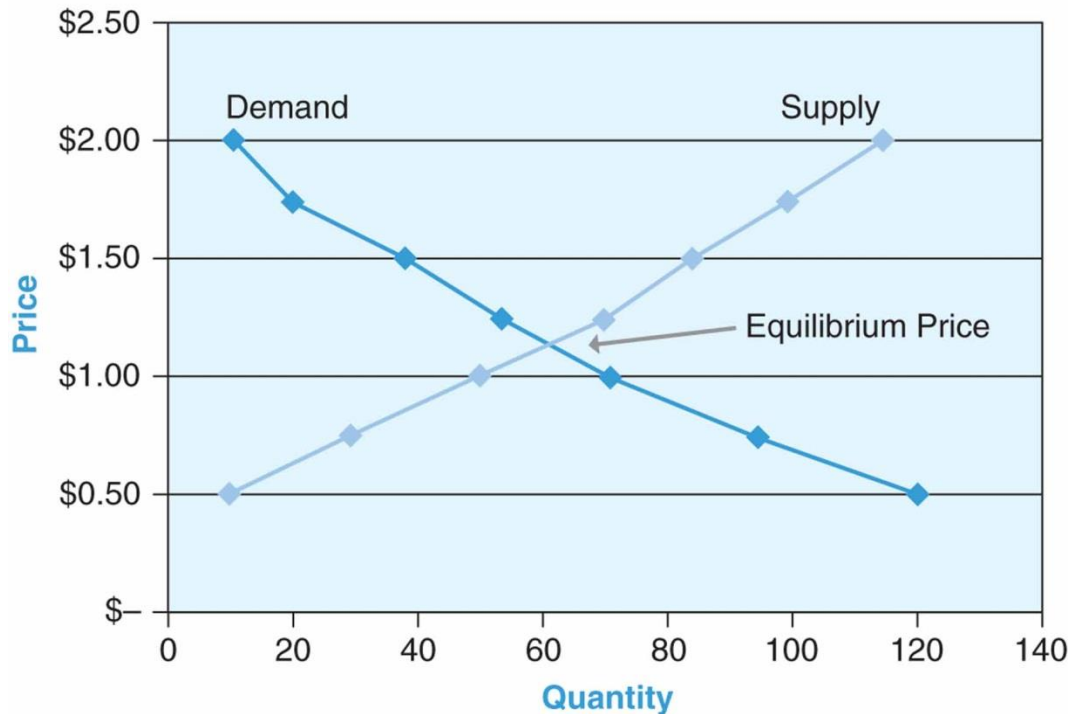


# Supply and Demand

- Law of supply—Amount suppliers want to provide:
  - increases as price increases
  - decreases as price decreases
- Supply curve—As price increases, quantity supplied increases.
- Law of demand—Amount buyers want to purchase:
  - increases as price decreases
  - decreases as price increases
- Demand curve—As price increases, quantity demanded decreases.

# Supply and Demand Curves and Eddie's Coffee Kiosk

Supply and Demand Curves - Coffee Kiosk



Important terms:

- Supply curve
- Demand curve
- Equilibrium point
- Surplus
- Shortage

**At \$2.00, how much coffee do suppliers want to provide?**

**How much coffee do buyers want to buy?**

**What is the dollar value for the equilibrium price?**

**What does this point mean?**

# Shifts in Supply and Demand

- **Determinants of Supply**
  - Technology changes
  - Number of suppliers
  - Change in resource prices
  - Price expectations
  - Price of substitute goods
- **Determinants of Demand**
  - Changes in income levels
  - Complementary goods
  - Population changes
  - Substitute goods
  - Consumer preferences



# Degrees of Competition

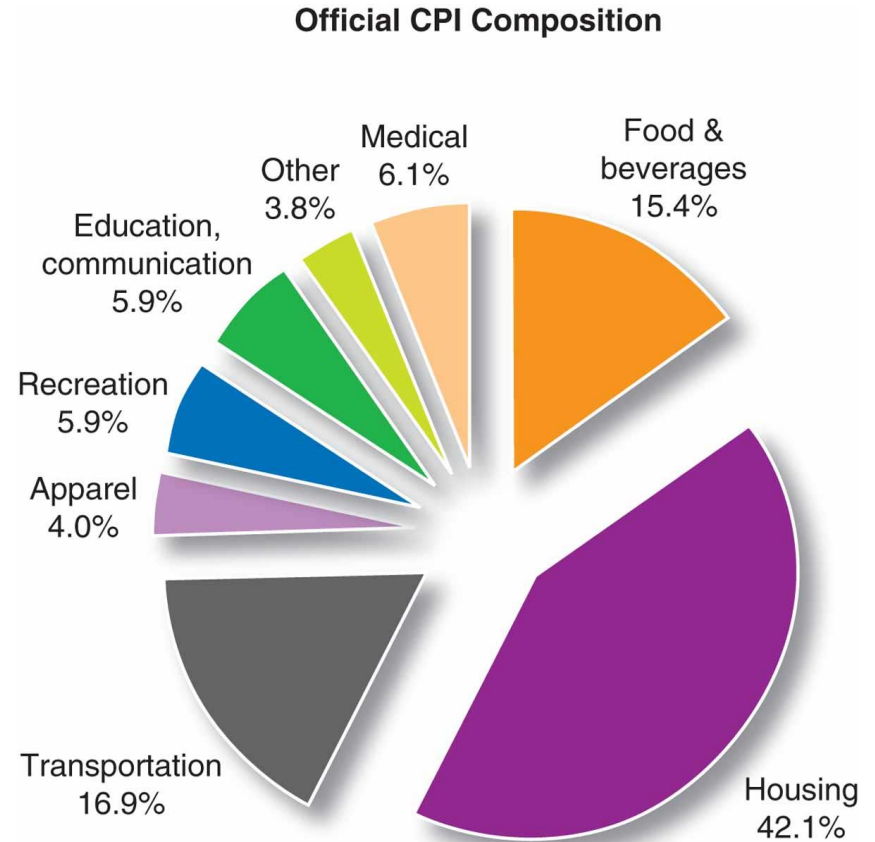
	Monopoly	Oligopoly	Monopolistic Competition	Perfect Competition
<b>Number of Providers</b>	One	Few	Many, but fewer than perfect	Many
<b>Similarity of Goods and Services</b>	Only one product is available	Relatively similar; product differences	Very similar, price and perceived differences	Virtually identical
<b>Ease of Entry into Industry</b>	Government regulated	High investment	Fairly easy	Relatively easy
<b>Supplier Control Over Price</b>	Considerable	Some	Some	None
<b>Examples</b>	Utility companies	Airlines, automobile industry	Laundry detergent, pizza, colas	Agricultural products

# Economic Indicators: GDP

- Gross domestic product
  - the broadest measure of economic activity
  - annualized quarterly percent changes in GDP reflect the growth rate of total economic output
- The broad components of GDP are
  - consumption
  - investment
  - net exports
  - government purchases
  - inventories

# Economic Indicators: CPI and PPI

- Consumer price index (CPI)
- Purchase price index (PPI)
- Inflation
- Disinflation
- Deflation



# Economic Indicators: Unemployment

- Unemployment rate
  - A measurement of the number of workers who are not working and who are actively looking for work
  - Frictional unemployment
  - Structural unemployment
  - Cyclical unemployment
  - Seasonal unemployment

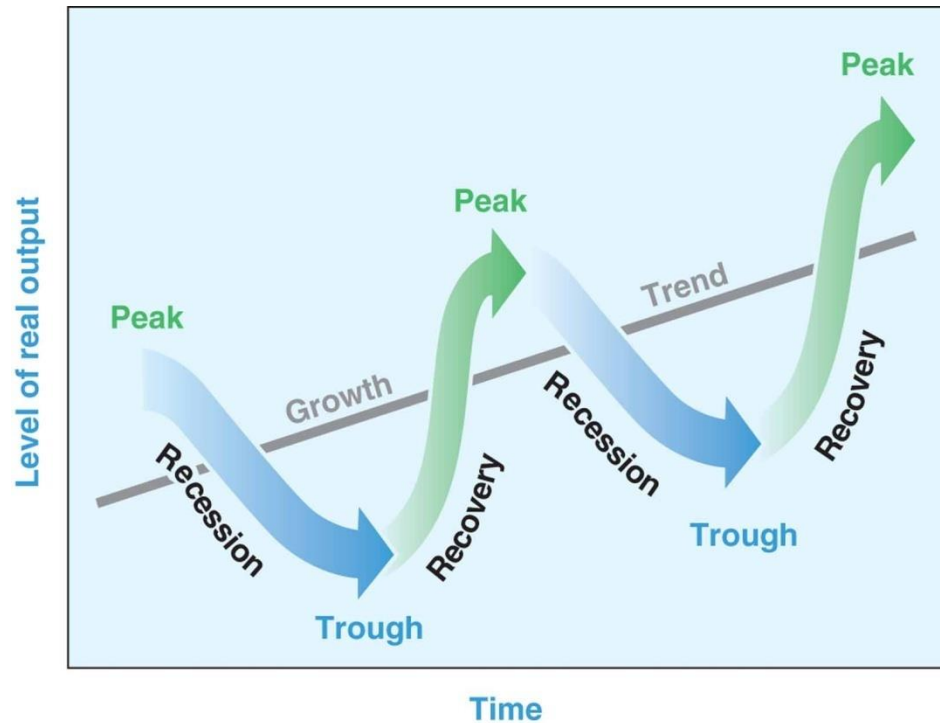
# Economic Indicators: Productivity

- Measurement of the quantity of goods and services that human and physical resources can produce in a given period of time

*Why is it important to measure  
and track productivity?*

# Business Cycle

- The state of the economy changes over time
  - Peak
  - Recession
  - Trough
  - Expansion/  
Recovery



# Fiscal Policy

- Fiscal policy relates to government management of revenues (taxes) and spending

*Why does the government increase taxes?*

*Why does the government decrease taxes?*

*How does government spending help stimulate the economy?*

# Monetary Policy

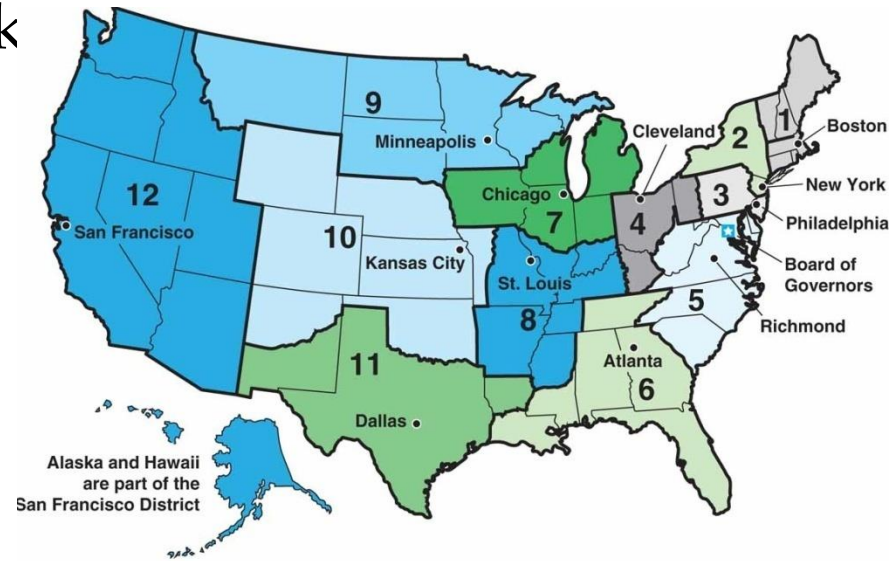
- Monetary policy relates to managing the amount of money in the system
  - Money supply: The total amount of money in the economy. It is measured in categories
    - M-1: Readily available money
    - M-2: M-1 plus money available to banks to lend out
    - M-3: M-2 plus less available money

*Why is measurement of the money supply important?*



# The Federal Reserve System

- “Fed” is central banking system in the U.S.
  - Independent government agency
  - 12 regional Federal Reserve Banks
  - 7-member Board of Governors
    - Chairman: Ben Bernank
- The Federal Open Market Committee sets policies of the Fed, including monetary policies



# Managing the Money Supply: Open Market Operations

- Open market operations
  - The primary, and most influential, tool the Fed uses to alter the money supply
  - Consists of buying and selling U.S. Treasury and federal agency bonds in the “open market”
  - To stimulate the economy, the Fed buys securities

# Managing the Money Supply: Discount Rate

- Discount Rate
  - Rate the Fed charges member banks
- Fed Funds Rate
  - Rate that banks charge other banks
- Lowering the discount rate encourages banks to borrow more money, which they in turn lend to businesses. This stimulates the economy.

# Managing the Money Supply: Reserve Requirement

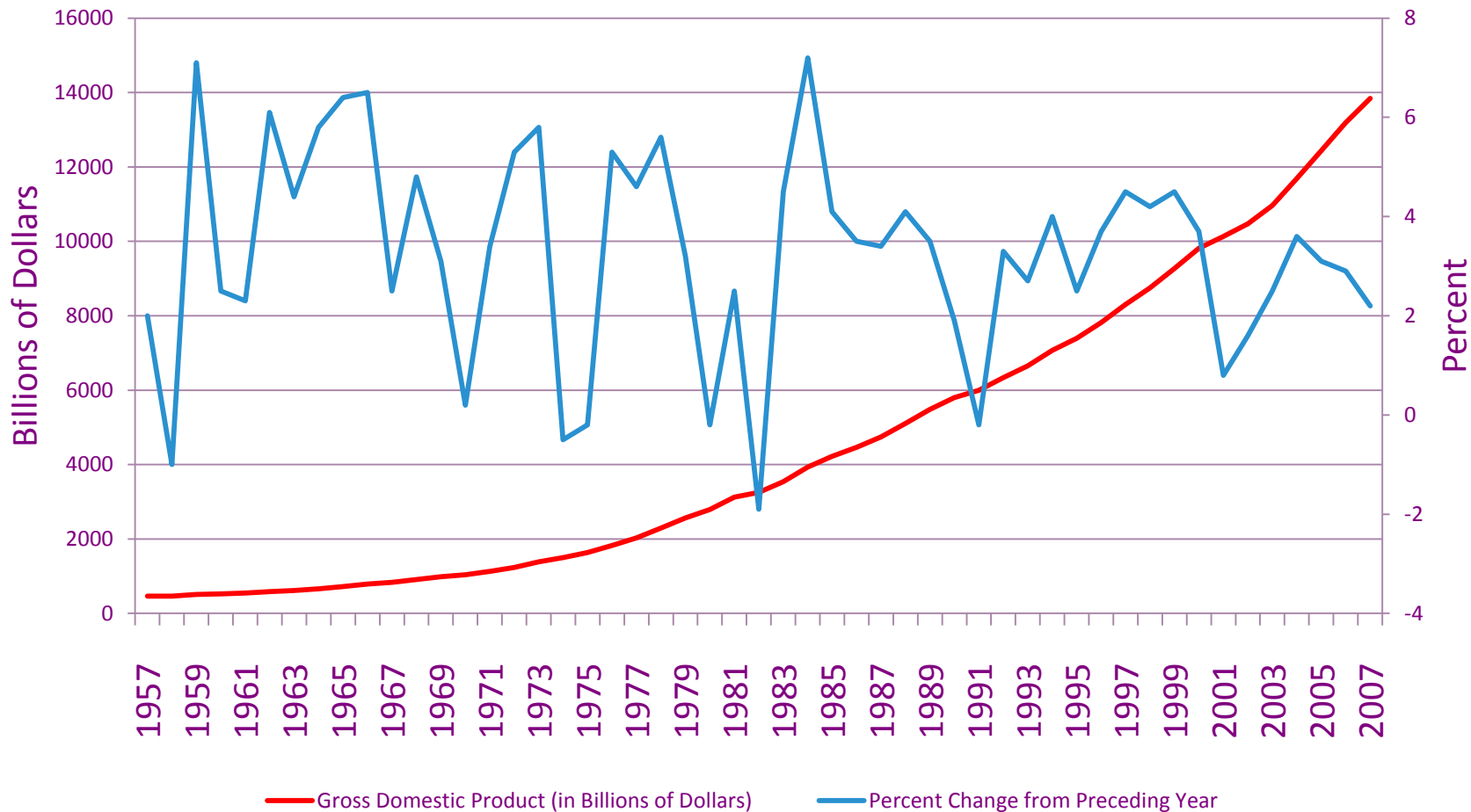
- Banks keep a reserve of money on hand to cover customer demands for funds.
- The Fed dictates what percent of deposits the bank must keep on hand.
- The reserve requirement is the least used monetary policy.

# Chapter Summary: Learning Objectives

1. What is **economics**, and what are the different types of economic systems?
2. What are the principles of **supply** and **demand** and the factors that affect each principle?
3. What are the four degrees of competition, and how does competition affect supply?
4. How do **economic indicators**, particularly the **gross domestic product (GDP)**, price indexes, the **unemployment rate**, and **productivity**, reflect economic health?
5. What are the four stages of the **business cycle**?
6. How does the government use both **fiscal policy** and **monetary policy** to control swings in the business cycle?

# **Beyond the Book**

# U.S. GDP Over the Last 50 Years



# The Better Economy?

- Which economy has had better performance in the past five years: The U.S. or Japan?
  - The U.S. average annual real GDP growth of 2.9% was much faster than Japan's 2.1%
  - Japan's GDP per person increased at an annual rate of 2.1% in the five years to 2007, slightly faster than the U.S.'s 1.9%



# Consumer Price Index

- The major categories of goods and services monitored for CPI
  - o Food and beverages
  - o Housing
  - o Apparel
  - o Transportation
  - o Medical care
  - o Recreation
  - o Education and communication
  - o Other goods and services
    - Tobacco and smoking products, haircuts, funeral expenses

Average Cost of a 16-oz. Bag of Potato Chips in U.S. Cities

Year	January Price	Percent Change
1998	\$3.15	
1999	\$3.22	2.11
2000	\$3.39	4.99
2001	\$3.39	0.15
2002	\$3.44	1.34
2003	\$3.48	1.32
2004	\$3.43	-1.60
2005	\$3.26	-5.28
2006	\$3.43	4.96
2007	\$3.36	-1.99
2008	\$3.53	4.84

# 2008 Economic Stimulus Package

- Signed by President George W. Bush on February 13, 2008, to address short-term economic uncertainties and stimulate consumer spending
- Included provisions for
  - Tax rebates of up to \$600 for individuals and \$1,200 for couples (plus \$300 per child)
  - Tax code changes allowing American businesses to deduct an additional 50% of new equipment purchased this year