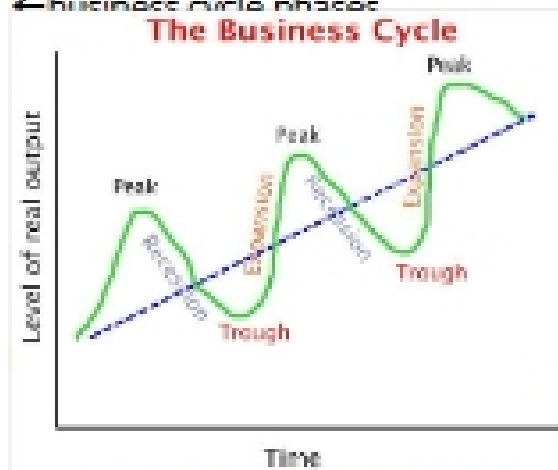


## Chapter 8 - Economic Fluctuations, Unemployment, and Inflation

- potential GDP (output) - the maximum sustainable level of output; actual can be greater or less than potential
- full employment - the "normal" rate of unemployment, the amount due to job shopping and imperfect information; actual employment can be higher or lower than full employment
  - "operating at potential GDP" means the same as "operating at full employment"
  - the economy is in neither a boom or bust, no cyclical unemployment present

### ← business cycle phases



- during a recession... unemployment is higher than the natural rate, actual GDP is below potential GDP, demand for resources is weak
- during a boom... unemployment is below the natural rate, actual GDP is above potential GDP, demand for resources is strong
- employment - has a job; unemployed - actively seeking employment or waiting to begin a job
- labor force participation rate - fraction of adult population that is in the labor force
- unemployment rate - percentage of the labor force that is unemployed
- frictional unemployment - caused by constant changes in the labor market; workers have the skills to fill job openings, imperfect information, and search activities
- structural unemployment - caused by changes in basic characteristics of the economy; some jobs become obsolete, new jobs are created, workers do not have the skills to fill openings; changes in public sector spending, minimum wage laws, and unemployment benefits
- cyclical unemployment - due to recession and inadequate labor demand; overall unemployment rate rises during recessions
- inflation - decline in the purchasing power of money; rising prices, rising (nominal) wages
  - unanticipated inflation - surprise to most
    - when inflation is high and variable, it is impossible to predict accurately
    - can lead to recession
  - anticipated inflation - expected by most
    - when inflation is low and stable, many can predict it accurately
    - stable prices enhance economic growth
  - why is inflation bad?
    - reduces investment - if we can't predict the future, we can't make long-term goals
    - distorts information and relative prices - less efficient allocation of resources, some prices change quickly while others don't
    - less productive use of resources - people spend time and money to predict and respond to inflation rates; less efficient allocation of resources