Contents

Acknowledgments ----- VII About the Author ----- IX Preface — XI **Chapter 1** Introduction to Global Macroeconomics ----- 1 The Basics — 1 Three Major Macroeconomic Markets ----- 3 Business Uses of Macroeconomic Analyses ----- 5 Macroeconomic Analysis for Economists and Policymakers ---- 7 Let's Begin! ---- 8 The Rest of the Story ----- 8 Four Major Business Planning Documents ----- 8 Conclusion ---- 10 Key Points — 11 Review Questions ----- 11 Discussion Questions — 12 **Chapter 2** Taking an Economic Pulse ----- 13 The Basics ----- 13 Nominal Gross Domestic Product — 13 Shortcomings of GDP as a Measure of Economic Health ---- 16 Circular Flow Diagram — 17 Macroeconomic Equilibrium — 25 The Rest of the Story ---- 27 A Second Way to View Macroeconomic Equilibrium — 27 Using the Circular Flow to Explain Recessions ---- 29 How Do Governments Actually Calculate GDP and GDI? ---- 31 Gross National Product ----- 34 Underground Economies — 36 Conclusion ---- 38 Kev Points ---- 38 Review Questions ----- 39 Discussion Questions ----- 41



Chapter 3 Labor Market Conditions ----- 43 The Basics — 44 Who Uses Labor Market Information? — 44 Measuring Employment and Unemployment ----- 46 Four Types of Unemployment ----- 51 Strengths and Weaknesses of Labor Market Measures ----- 55 Final Comments on Interpreting Unemployment Rate and Employment-to-Population Ratio ----- 59 The Rest of the Story ---- 60 Other Labor Market Measures — 60 If Only I Could Be a Fly on the Wall — 63 Natural Rate of Unemployment ---- 65 Outsourcing, Offshoring, and Reshoring ---- 66 Conclusion — 71 Kev Points ----- 72 Review Questions ---- 74 Discussion Questions — 74 **Chapter 4** Inflation and Real GDP ----- 77

The Basics — 77 What Is Inflation? — 77 Inflation Measures — 79 What Is Price Stability? — 82 Real Versus Nominal GDP — 83 The Rest of the Story — 85 Weaknesses of the CPI — 85 Conclusion — 88 Key Points — 89 Review Questions — 90 Discussion Question — 90

Chapter 5

Inflation: Who Wins, and Who Loses? — 91 The Basics — 91 Inflation Diminishes Purchasing Power — 91 Framing the Inflation Issue — 92

Debtors Versus Creditors ----- 94 Businesses Versus Workers ----- 99 Governments Versus Taxpavers — 100 Does Inflation Hurt Retirees? — 101 Does Inflation Hurt the Nation as a Whole? ---- 102 The Rest of the Story ---- 104 Indexation ---- 104 How to Profit from a Negative Real Interest Rate ---- 106 Calculating Nominal Interest Rates with the Precise Formula — 107 Estimating Market Expectations about Future Inflation ---- 108 Inflation and the Cost of Higher Education ----- 110 Conclusion ---- 111 Key Terms — 111 Review Questions ----- 112 Discussion Questions ----- 113 Chapter 6 Monetary Aggregates — 115 The Basics ---- 115 Commodity Money Versus Fiat Money ----- 115 Functions of Money — 117 Why Do Nations Measure Their Money Supplies? ---- 118 Monetary Aggregates — 120 The Rest of the Story ---- 126 U.S. Monetary Aggregates ---- 126 Financial Assets Included in the U.S. M1 and M2 Money Supplies — 128

Conclusion — 131

Key Points — 131

Review Questions — 132

Discussion Questions ---- 133

Chapter 7

Financial Intermediation — 135 The Basics — 135 Financial Intermediaries — 135 Overview of a Typical Bank's Balance Sheet — 139 Check Clearing — 146 The Rest of the Story — 149 Financial Disintermediation — 149 International Check Clearing — 152 XXVI ---- Contents

Check Clearing and Company Cash Management — 153 Causes of Bank Failures — 155 Conclusion — 157 Key Points — 158 Review Questions — 159 Discussion Questions — 160

Chapter 8

Money Creation — 161

The Basics — 161 Creation of Money by a Single Bank — 161 Money Creation by the Banking System — 171 The Rest of the Story — 178 Preferred Asset Ratios and the M1 and M2 Money Multipliers — 178 Conclusion — 187 Key Points — 187 Review Questions — 188 Discussion Questions — 191

Chapter 9

Central Banks ----- 193 The Basics ---- 193 Financial Regulation Versus Monetary Policy ----- 193 $M2 \equiv M2$ Money Multiplier × Monetary Base ---- 194 Guideline #1: Above the Line/Below the Line ----- 195 Monetary Tools of the Central Bank — 199 Monetary Tools in Action ---- 213 Lags in Monetary Policy ---- 214 Summary of "The Basics" ---- 215 The Rest of the Story - 216 Central Banking: A Balance Sheet View — 216 Can a Central Bank Become Insolvent? ---- 222 Macroprudential Regulations ---- 223 Monetary Policy Targets — 224 Monetary Effects of Central Bank Foreign Exchange Market Intervention ---- 230 Central Banks Around the World ---- 234 Conclusion ---- 237 Key Points ---- 238

Review Questions — 240 Discussion Questions — 241

Chapter 10

Real Credit Markets ---- 243

The Basics — 243

Clarifying Financial Markets — 243

Inverse Relationship Between Debt Prices and Interest Yield — 245 Cost of Real Credit — 245 Determining Credit's Real Cost and Quantity Per Period — 251 Shifts in the Supply and Demand for Real Credit — 257

Real Credit Market Examples — 266

The Rest of the Story — 273

Can Central Banks Set Interest Rates? ---- 273

Conclusion — 275

- Key Points **276**
- Review Questions ----- 278
- Discussion Questions ----- 279

Chapter 11

The Economics of Cryptocurrencies ---- 281 The Basics — 281 Legal Tender, Fiat, Digital, and Cryptocurrencies — 281 Buying, Selling, and Using Cryptocurrencies — 283 Blockchain, Altcoins, and Enterprise Distributed Ledger Technology ---- 286 Cryptocurrency Exchange Rate Determination ---- 288 Cryptocurrencies and Monetary Policies ---- 291 Taxation and Government Regulation — 293 Are Cryptocurrencies "Money"? — 294 National and Central Bank Digital Currencies ---- 299 The Future of Cryptocurrencies — 302 The Rest of the Story ----- 304 Bitcoin — 304 Conclusion ---- 307 Key Points ---- 309 Review Questions — 310 Discussion Questions — 310

Chapter 12 Real Goods and Services Markets ----- 313 The Basics ---- 313 Aggregate Supply Curve ----- 313 Aggregate Demand Curve — 322 Macroeconomic Equilibrium ----- 328 Don't Confuse Price Level Increases with Increasing Inflation ----- 330 Spending Multiplier — 331 Applications ----- 336 The Rest of the Story ----- 340 Demand Pull, Cost Push, and Spiral Inflation ---- 340 Hyperinflation and Deflation — 346 Actual Quantity Supplied Always Equals Actual Quantity Demanded ---- 350 Why Does a Nation's Aggregate Demand Slope Downward? ---- 352 Conclusion ---- 356 Key Points ----- 358 Review Questions ---- 359 Discussion Questions ---- 361

Chapter 13

Fiscal Policy — 363
The Basics — 364
What Is Fiscal Policy? — 364
Taxes and Other Sources of Government Revenues — 365
Government Deficits, Surpluses, and Debts — 366
The Fiscal Multiplier, Crowding-Out, and Crowding-In — 373
Government Surpluses 377
Automatic Stabilizers — 378
Fiscal Policy in Action — 380
Lags in Fiscal Policy — 381
Monetary Effects of Fiscal Policy — 382
The Rest of the Story — 384
Putting Government Debt into Perspective — 384
A Closer Look at Monetary Effects of Fiscal Policy 387
Greece: Consequences of a Misestimated Fiscal Multiplier 391
Structural Versus Cyclical Deficits and Surpluses 392
Crowding-Out: When Is It Complete, Nonexistent, or Partial? 400
Conclusion — 403

Key Points — 404 Review Questions — 405 Discussion Questions — 406

Chapter 14

Business Cycles — 409
The Basics — 409
What Are Business Cycles? —— 409
How Are Business Cycles Measured? — 409
What Causes Business Cycles? — 411
The Rest of the Story — 415
U.S. Business Cycles — 415
U.S. Business Cycles from 1947 to 2019 417
Conclusion 422
Key Points 423
Review Questions — 423
Discussion Question — 424
Chapter 15
Foreign Exchange Basics — 425
The Basics — 425
Exchange Rates — 425
The Foreign Exchange Market 427
Participants in the Foreign Exchange Market — 432
Checking Accounts Never Leave the Country — 436
Spot Foreign Exchange Market — 438
The Rest of the Story — 439
Understanding Spot Foreign Exchange Quotations 439
Buying and Selling Foreign Exchange: Bid and Ask Rates — 440
The Major Segments of the Foreign Exchange Market — 444
Conclusion — 446
Key Points 447
Review Questions — 448
Discussion Question — 449
Chapter 16
Foreign Exchange Markets 451
The Basics — 451
Measuring a Currency's Value — 451
- · ·

Bilateral Versus Effective Exchange Rates ----- 452

Nominal Versus Real Exchange Rates — 453 How Are Exchange Rates Determined? ---- 461 What Causes Exchange Rates to Change? — 471 The Rest of the Story ----- 482 International Exchange Rate Systems ---- 482 To Fix or Not to Fix, That is the Question — 486 What Is the European Monetary Union? — 489 Should There Be One Global Currency? ----- 490 Conclusion ---- 492 Key Points ---- 493 Review Questions — 495 Discussion Questions — 496 Chapter 17 Balance of Payments — 499 The Basics — 499 What Is the Balance of Payments? ----- 499 Major Parts of the Balance of Payments ----- 500 Balance of Payments Identity ----- 510 Net Export Identity ----- 511 The Rest of the Story ----- 517 Balance of Payments Measures ----- 517 Are Current Account Deficits Harmful or Beneficial? ----- 521 Frequently Asked Questions about the Balance of Payments ----- 524 The Balance of Payments and Double-Entry Bookkeeping ----- 525 Understanding IMF Balance of Payments Reports ----- 528 Conclusion ----- 535 Key Points ---- 536 Review Questions ----- 537 Discussion Questions ----- 542 Chapter 18 Putting It All Together — 543 The Basics ----- 543 The Three-Sector Model and Common Sense ----- 543 Integrating Macroeconomic Markets — 545 Conclusion ----- 559 Kev Points ----- 560

Review Questions ----- 561

Chapter 19

Shocks to Nations with Flexible Exchange Rates — 563

The Basics — 563 Effects of Expansionary Fiscal Policy — 563 Effects of Expansionary Monetary Policy — 585 The Rest of the Story — 598 Feedback Effects in the Three-Sector Model — 598 A Second Look at Expansionary Fiscal Policy with Low Mobility International Capital Markets — 602 Conclusion — 603 Key Points — 604 Review Questions — 605 Discussion Questions — 611

Chapter 20

Shocks to Nations with Fixed Exchange Rates ---- 615

The Basics — 615

Why Do Nations Choose Fixed Exchange Rates? — 615 How Do Nations Fix Their Exchange Rates? — 617 Effects of Expansionary Fiscal Policy — 623 Effects of Expansionary Monetary Policy — 639 The Rest of the Story — 647 Balance of Payments Accounting and Central Bank Intervention — 647 Conclusion — 652 Key Points — 653 Review Questions — 653 Discussion Questions — 657

Chapter 21

Causes, Cures, and Consequences of the Great Recession — 659 The Basics — 661

Measures of Economic Devastation — 661 U.S. Housing Market and the Great Recession — 662 Fixing the Credit and Goods and Services Markets — 676 Wall Street Reform and Consumer Protection Act — 685 More Than a Decade Later, Is Our Financial System Safer? — 687 Were U.S. Monetary and Fiscal Policies Effective? — 689 Did the Bailout Earn the U.S. Government a Return? — 689 The Next Financial Crisis — 690

Paradoxes of the Great Recession — 690 Conclusion ---- 697 The Rest of the Story ---- 698 Fannie Mae and Freddie Mac ---- 698 Securitization: From Mortgage Origination to Security Sales ---- 701 Using Taxpayer Money to Bail Out the Rich ---- 704 Chronology of Major Events: 2007-2009 ---- 704 Acts That Deregulated the U.S. Financial Industry — 707 Abridged Chronology of U.S. Government Actions: 2007–2009 ---- 708 Abridged Chronology of Federal Reserve and Federal Deposit Insurance Corporation Actions: 2007–2009 ---- 710 Key Points ---- 711 Review Questions ---- 712 Discussion Questions ---- 713 Chapter 22 Long-Term Growth and Development ----- 715 The Basics — 715 Scenario Planning ---- 715 Economic Growth and Development ---- 716 Economic Growth and the Importance of Compounding ----- 722 Government's Role in Economic Development — 723 Comparative Advantage ---- 725 The Rest of the Story — 732 A Country Is Not a Company ---- 732 Conclusion ---- 737 Kev Points — 739 Review Questions ---- 740 Discussion Question ---- 741 Chapter 23 Long-Term Inflation, Exchange Rates, and Unemployment ---- 743

The Basics — 744 Phillips Curve and the Natural-Rate Hypothesis — 744 Equation of Exchange — 753 Monetarism and the Quantity Theory of Money — 756 Long-Term Changes in Exchange Rates — 764 Linking Purchasing Power Parity Theory and Quantity Theory of Money — 769 The Rest of the Story — 771 How Well Does PPP Predict Exchange Rates? — 771 Income Velocity Versus Transactions Velocity — 774 Conclusion — 775 Key Points — 777 Review Questions — 778 Discussion Questions — 780

Appendix A List of Abbreviations ----- 781

Appendix B Important Terms and Concepts ---- 785

Index — 791