

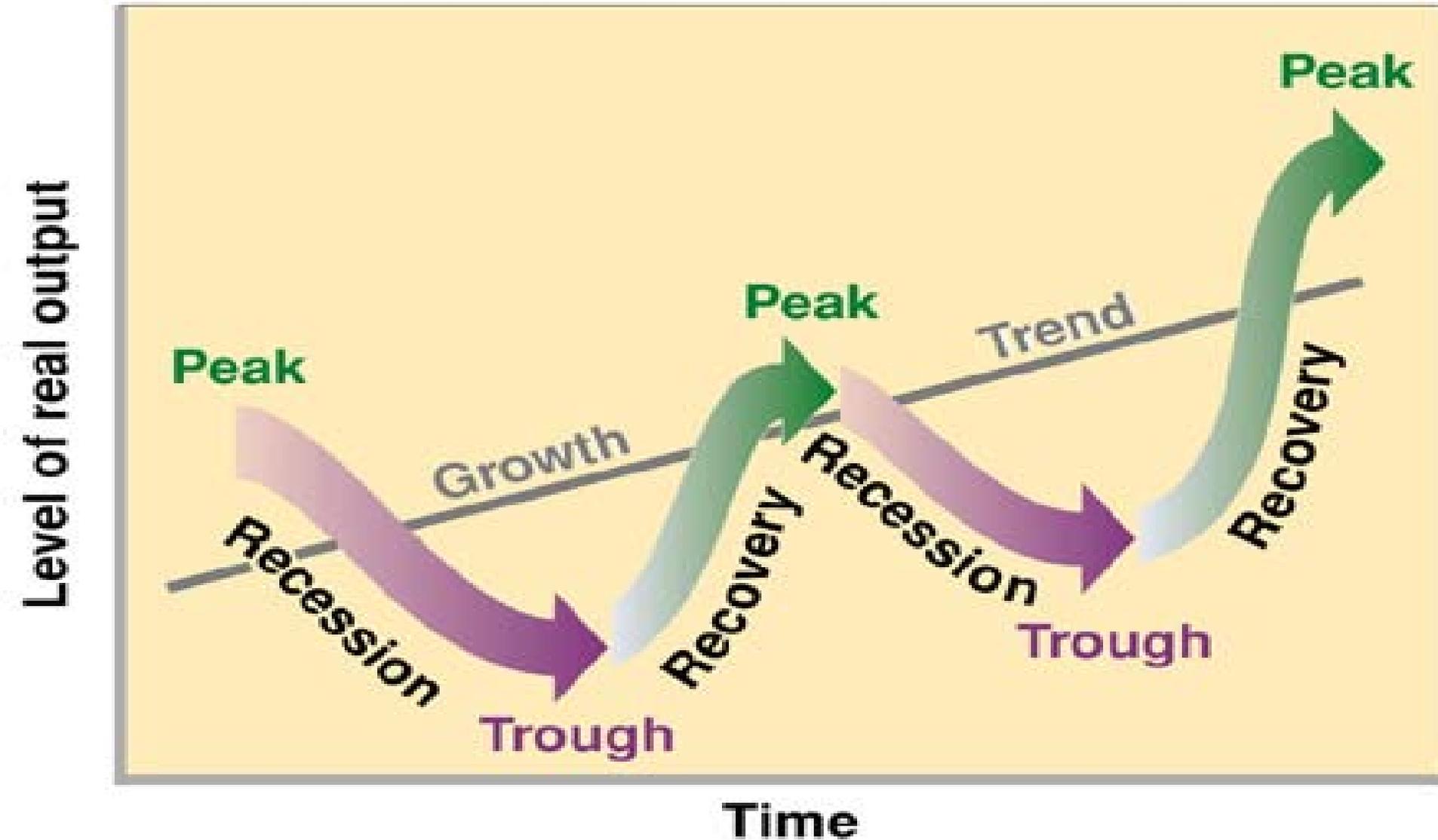
AP Macroeconomics

The Business Cycle and Unemployment

The Business Cycle

- The United States' GDP is not constant from year to year.
- Instead, the GDP grows most years and then shrinks in some years.
- The ups and downs in GDP over time is referred to as the business cycle.

The Business Cycle Illustrated:



The Business Cycle Illustrated:

- **Peak**
 - temporary maximum in Real GDP. At this point the unemployment rate ($u\%$) is probably below the natural rate of unemployment, and the inflation rate ($\pi\%$) is probably increasing.
- **Recession**
 - The contractionary phase of the business cycle. A period of decline in Real GDP accompanied by an increase in $u\%$. To be classified as a recession, the economic decline must be at least 6 months long.
- **Trough**
 - The bottom of the business cycle. The $u\%$ is probably high and $\pi\%$ is probably low.
- **Recovery**
 - The phase of the business cycle where the economy is returning to full employment.

The Business Cycle Illustrated:

- Important note
 - The various phases of the business cycle last for different amounts of time.
 - In recent history, expansions have lasted years longer than have recessions.
 - The Great Depression is the most notable example of a long recession/trough

The Business Cycle Illustrated:

- Causes
 - Irregularity of Investment
 - Changes in productivity
 - Changes in total spending (aggregate demand)
- Durable goods manufacturing is most susceptible to the effects of the business cycle
- Business cycle has become less severe because of technological advancements in supply-chain management and structural changes in U.S. economy.

Unemployment

- **Class Activity**

Unemployment

- Population
 - Number of people in a country
- Labor force
 - Number of people in a country that are classified as either employed or unemployed
 - Labor Force Participation Rate
 - % of working age population in the labor force (U.S. is approx 66%)
- Employed
 - People 16 years and older that have a job.
 - It doesn't matter if it's part-time or full-time, as long as they work at least 1 hour every 2 weeks
- Unemployed
 - People 16 years and older that don't have a job, but have actively searched for a job in the last 2 weeks
 - Unemployment rate = $\# \text{ of unemployed} / \# \text{ of people in labor force}$
- Not in Labor Force
 - Kids, military personnel, retired people, stay at home Moms and Dads, full-time students, your 40 year old uncle who sleeps on the couch all day, most of the homeless.

Types of Unemployment

- **Frictional**
 - “between jobs”, voluntary, good for individuals and society
- **Structural**
 - Associated with lack of skills or declining industry (ex. High school dropouts, type-writer repairmen). Think “Creative Destruction”
- **Cyclical**
 - Associated with downturns in business cycle. Bad for society and individuals.
- **Seasonal**
 - Mall Santas, Schlitterbahn Life-guards, Ride operators at Fiesta Texas, Golf-pros in Alaska during January.

Full Employment

- Occurs when there is no cyclical unemployment present in the economy
- Associate with the Natural Rate of Unemployment (NRU).
 - The level of unemployment experienced when the economy is producing at its full potential.
 - The United States' NRU is approx. 4%-5%
- Associate Full Employment (FE) with the PPC, the long-run aggregate supply (LRAS) and the long-run Phillips curve (LRPC)

Why Unemployment is bad

- Okun's Law- Every 1% increase in the $u\%$ causes a 2% decline in Real GDP.
- The burden of unemployment is not equally shared in society.
- It causes social unrest and is hard on individuals and families.