Macroeconomic variables are the ones that are related to the entire economy unlike microeconomic variables that are just related to one particular industry or sector. Following is the list of macroeconomic variables:

1. GDP
2. Inflation
3. Exchange Rate
4. Unemployment
5. Balance of Payments

Interrelatedness of macroeconomic problems refers to the idea that any change in one macroeconomic variable can lead to a change in another macroeconomic variable and therefore the 2 variables could be interrelated to each other. For instance, a change in exchange rate could result in change in the balance of payments value of a country and therefore the macroeconomic policy of the country should be mindful of this relationship.

Relationship between Internal and External Value of Currency

Internal Value of Currency: refers to the currency's purchasing power in terms of local goods and services. For instance, what quantity of goods and services a $100 bill can buy in the US, would be dollars internal value of currency.

External Value of Currency: refers to a currency's purchasing power in terms of other currencies which is basically called the exchange rate.

Internal value of currency decreases due to inflation in an economy. During times of higher inflation rates the prices of goods and services are increasing at a fast rate and therefore a certain amount of local currency would buy lower quantities of local goods and services and vice versa.

Internal value of currency is therefore inversely related to the country's inflation rate.

Higher inflation in an economy would mean that a country's products are less competitive on international markets and therefore there would be lower demand for the country's products, hence lower exports. Due to lower exports the demand for a country's currency will decrease and therefore its exchange will depreciate against other currencies (meaning a decrease in the external value of currency).

Hence, lower the internal value of currency, lower the country's external value of currency and vice versa.

MEGA LECTURE

Relationship between Inflation and Balance of Payments

When inflation is higher the country's products are becoming more expensive and therefore less price competitive on international markets. Therefore, the demand for country's products is expected to be lower, hence lower exports and more imports causing a Balance of Payments deficit.

Relationship between Inflation and Unemployment

A New Zealand economist, named Phillip, sometime back was intrigued by the relationship between inflation and unemployment. So he gathered countries' inflation and unemployment statistics and plotted the graph for the 2 variables which is known as Phillips Curve.

What he observed was an inverse relationship between inflation and unemployment. Higher unemployment means more people are out of work and therefore average incomes are lower resulting in lower consumption in an economy. With lower consumption the aggregate demand for the economy is low causing lower inflation and vice versa.

As far as Classical economists are concerned, they think that the trade-off between inflation and unemployment only exists in the short run and in the long run the Phillips Curve is a straight vertical line.

The long run Phillip Curve is vertical line because Classical Economists think that any government attempts to reduce unemployment beyond the Non-Accelerating Natural Rate of Unemployment (NAIRU) would only result in higher inflation and that would not reduce unemployment below the NAIRU level.

Conflicts between Macroeconomic Policies

When a government policy like Fiscal, Monetary or Supply Side Policies are achieving one objective, but for that the government has to compromise on another objective.

Failure of Government Policies

MEGALECTURE

Not always government is able to implement all of its policies efficiently like they might miscalculate the tax rates or the government might not spend on projects where government spending is most needed and so on.

Laffer Curve Analysis

It is a graph that shows the relationship between tax rate (on the x-axis) and tax revenue which is on the (y-axis).

It is an inverted U graph which simply shows the fact that uptil a certain tax rate the government's tax revenue would rise but beyond a certain percentage of tax the government tax revenue would start decreasing as it would create disincentives to work (for example people might not want to work extra hours knowing that a big portion of extra income would be taken away by the government in taxes and so on).

MEGA LECTURE