Key Economic Concepts for the Euro Challenge

Student Orientations

2016 Euro Challenge

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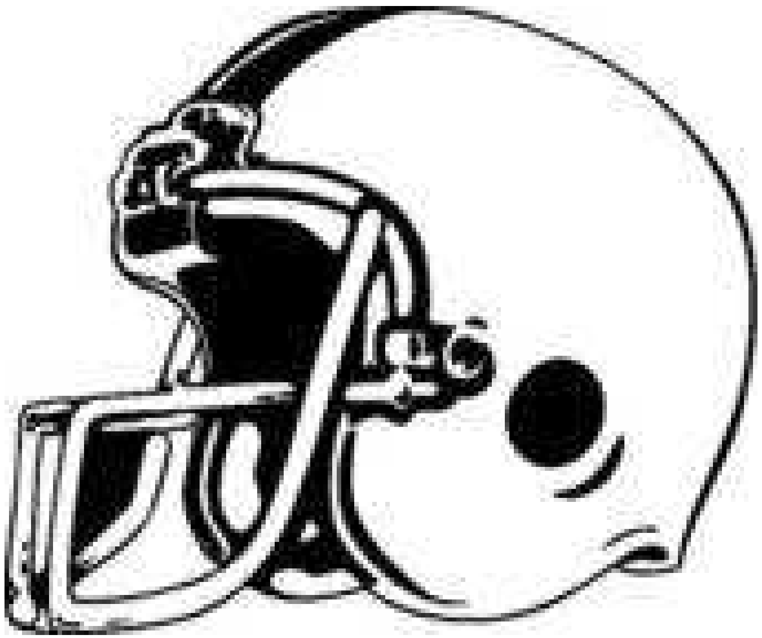
Key economic concepts for the Euro Challenge

Describe the current season of your team



Imagine you had to describe the current season of your favorite football team

You can summarize their season by focusing on different *indicators*

- **Games won, lost, tied**
- **Total yards, rushing, passing**
- **Touchdowns, sacks, field goals**

These are all indicators

They help to explain the teams' season

Will your team go to the Superbowl?

GDP growth: a key economic indicator

Gross Domestic Product measures everything produced by an economy (both goods and services)

- *Gross Domestic Product* (GDP) is the total value of all the goods (e.g. cars, iPods) and services (e.g. haircuts, insurance policies) produced by an economy

- *GDP growth* tells you by how much GDP has increased compared to the last year (or last quarter)

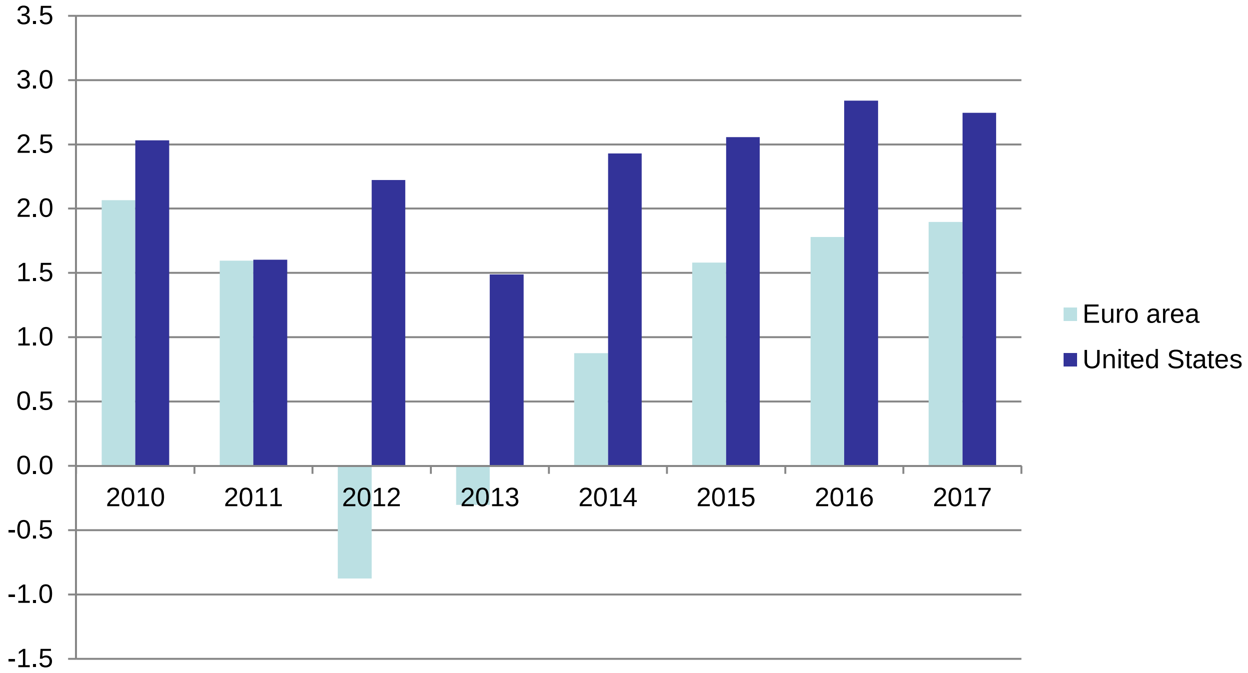
- GDP growth is expressed as a *percentage*

- When the economy is growing, GDP growth is a *positive number*

- In a recession, GDP growth is *negative* (GDP shrinks)

Euro area GDP is gradually recovering

Euro area and U.S. real GDP growth, in %



The euro area economy returned to positive growth this year and is recovering.

Source: European Commission, Autumn forecast, Nov. 2015

Hint: For explanations and updates, see "Current Economic Situation in the Euro Area" on the Resources page

Unemployment

• The basic definition of unemployment is the number of people that are actively looking for work and have not found it in a certain period.

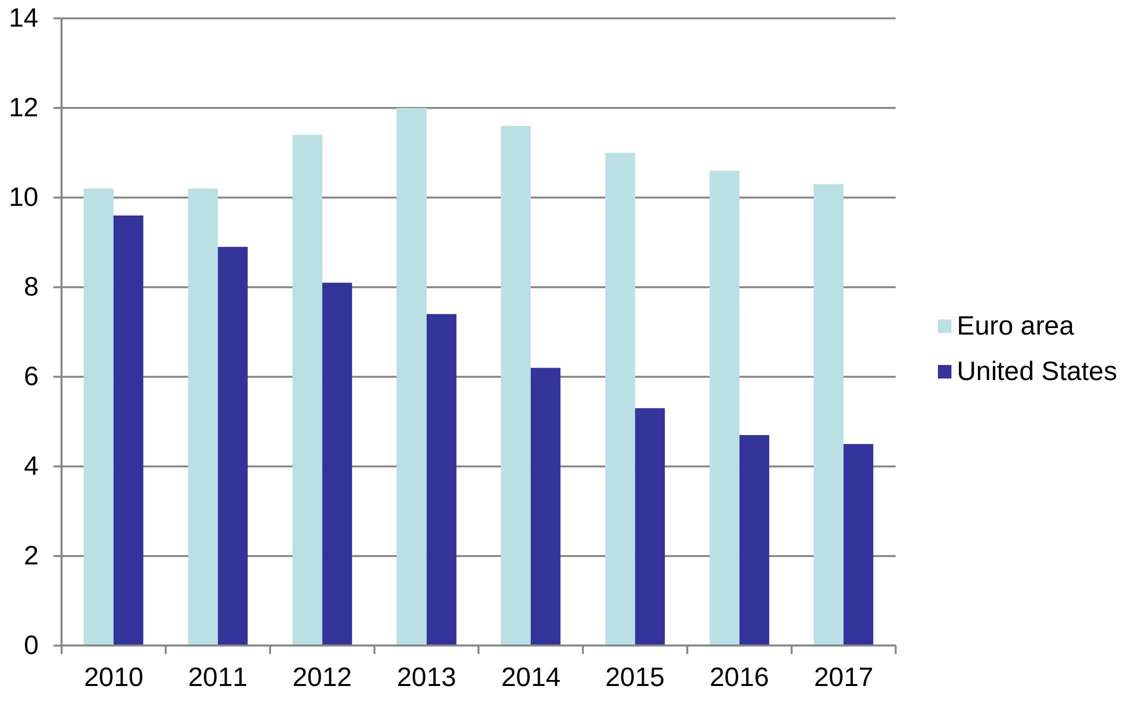
• The unemployment rate is the share of the working-age population that is looking for work but not employed.

• Unemployment normally rises in times of slow or declining GDP growth, and tends to fall in times of stronger GDP growth.

• As economic activity increases, firms hire more workers to produce the goods and services people are consuming.

Unemployment remains high

Euro area and U.S. unemployment rate, in %



Source: European Commission, Autumn forecast, Nov. 2015

The unemployment rate in the euro area was falling prior to the 2008-09 crisis, but it increased during the crisis years and is now declining only gradually.

There are huge differences in unemployment rates among euro area countries (ranging from 5% to around 25%).

Inflation

• Inflation is the general increase in the level of certain measured prices over a certain period. It is expressed as a percentage change.

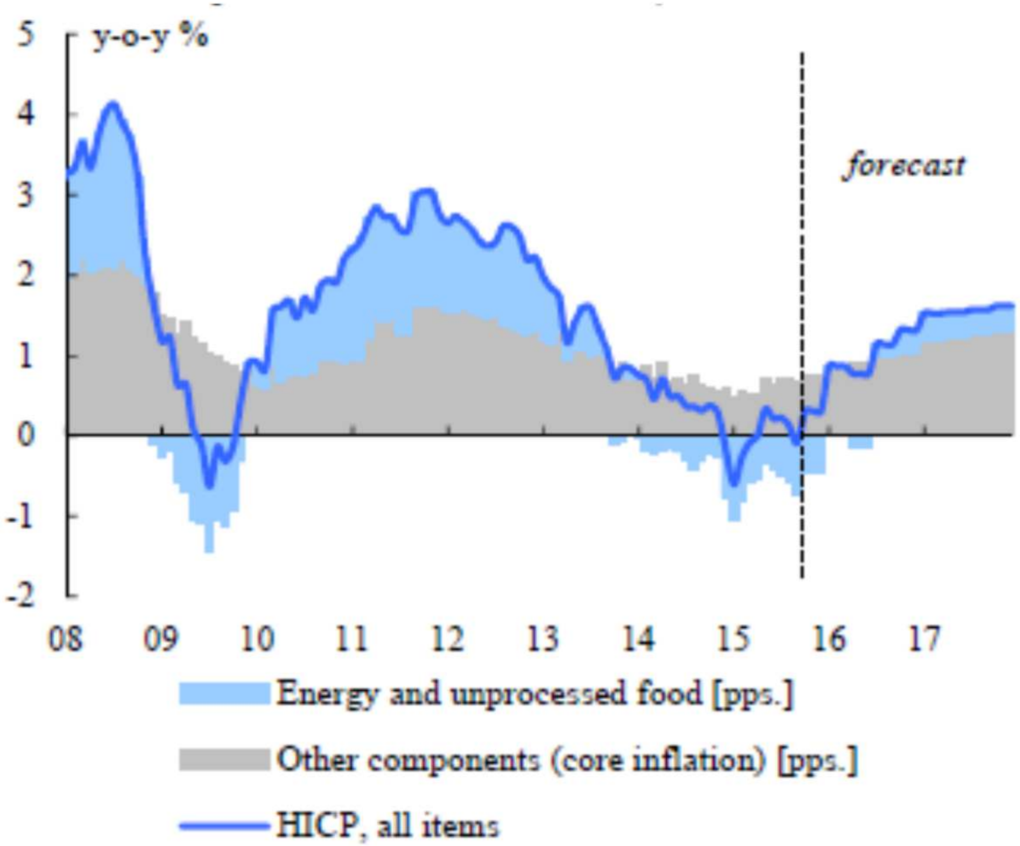
• A little inflation is fine, even desirable, but too much of it can be damaging, both to people's livelihoods and to the economy as a whole.

• High inflation usually occurs when an economy is over-heating (growing too quickly). When growth is too weak, there may be a risk of deflation (falling prices) – which sounds great but can be very bad!

HINT: For all you need to know about inflation/deflation and the ECB, go to http://vimeo.com/12324309

Inflation has been low but is expected to pick up soon

Inflation Breakdown, Euro Area



Source: European Commission, Autumn Forecast, 2015

Low inflation has been caused primarily by declining energy prices.

But the impact should prove transitory and euro area inflation is expected to begin rising as the economy improves and the unemployment rate falls further.

High debt and deficits

- The *deficit* is the difference between the amount of money a government takes in (revenue) and what it spends (outlays) in a given year. If that number is positive, there is a *surplus.*

  The *debt* is the total amount of money the government owes. It is usually expressed as a percentage of GDP.

  A debt level that is too high can lead to higher borrowing costs and slower economic growth. And slower GDP growth makes it more difficult to reduce deficits and debt!

What is monetary policy?

The euro area's monetary policy is run by the ECB

- Monetary policy is the process by which a central bank controls the supply of money for the purpose of steering economic growth and limiting inflation.

- By setting interest rates, central banks can influence borrowing and lending decisions by households and firms. Lower interest rates generally spur economic activity, while higher interest rates slow inflation down.

- Monetary policy can be described as *neutral*, *expansionary* ("loose/easy"), or *contractionary* ("tight"). The ECB targets and inflation rate of close to, but below, 2%, and adjusts monetary policy to meet that target.


Good luck in the
Euro Challenge 2016!