# AQA Economics AS-level

## Macroeconomics

## Topic 3: Economic Performance

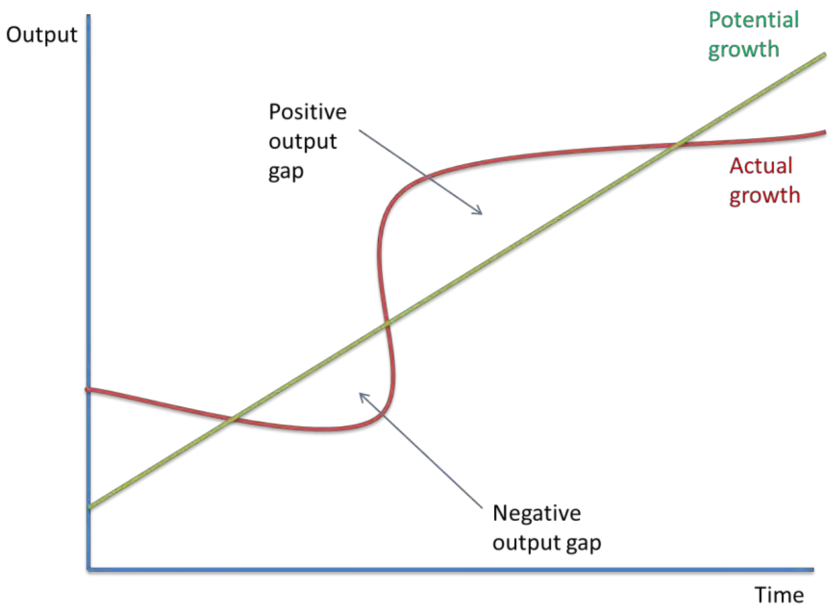
### 3.1 Economic growth and the economic cycle

Notes

### The difference between short run and long run growth

- **Short run growth** is the percentage increase in a country's real GDP and it is usually measured annually. It is caused by increases in AD.
- **Long run economic growth** occurs when the productive capacity of the economy is increasing and it refers to the trend rate of growth of real national output in an economy over time. It is caused by increases in AS.
- The potential output of an economy is what the economy could produce if resources were fully employed.

### Positive and negative output gaps:



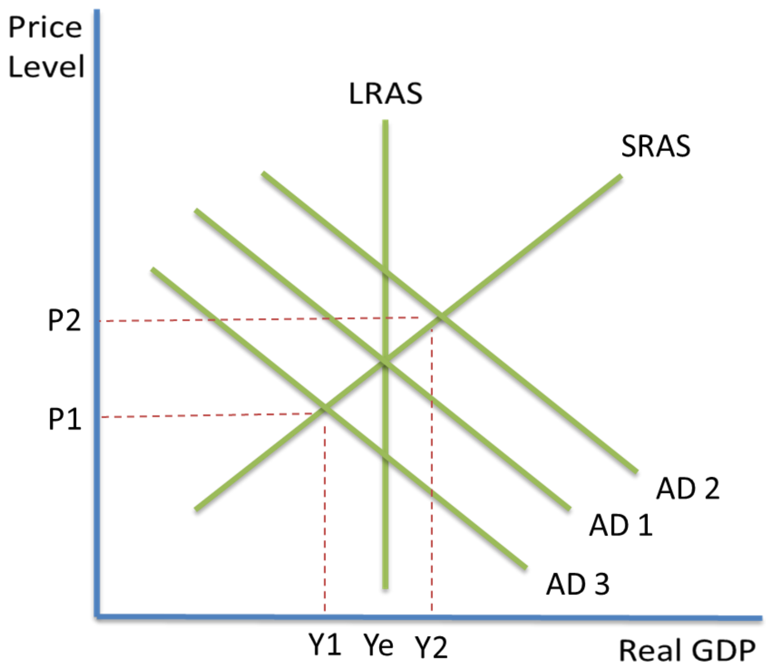

- An output gap occurs when there is a difference between the actual level of output and the potential level of output. It is measured as a percentage of national output.

- A **negative output gap** occurs when the actual level of output is less than the potential level of output.
  This puts downward pressure on inflation. It usually means there is the unemployment of resources in an economy, so labour and capital are not used to their full productive potential. This means there is a lot of spare capacity in the economy.

- A **positive output gap** occurs when the actual level of output is greater than the potential level of output.

It could be due to resources being used beyond the normal capacity, such as if labour works overtime. If productivity is growing, the output gap becomes positive. It puts upwards pressure on inflation.
Countries, such as China and India, which have high rates of inflation due to fast and increasing demand, are associated with positive output gaps.

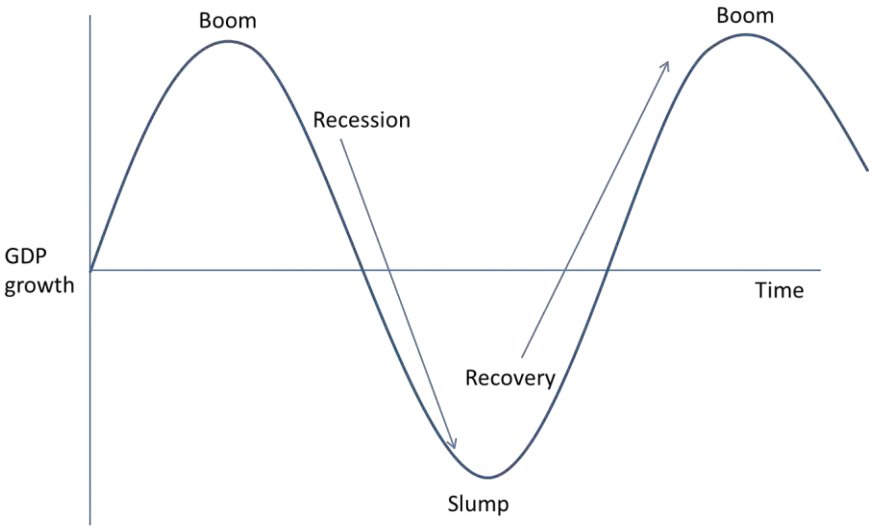
## Illustrating an output gap:




Classical economists believe markets clear in the long run, so there is full employment. They believe there are output gaps in the short run. A negative output gap is between Ye and Y1, and a positive output gap is between Ye and Y2.

## The business cycle:

- This refers to the stage of economic growth that the economy is in.
- The economy goes through periods of booms and busts.




- Real output increases when there are periods of economic growth. This is the recovery stage.
- The boom is when economic growth is fast, and it could be inflationary or unsustainable.
- During recessions, the real output in the economy falls, and there is negative economic growth.
- During recessions, governments might increase spending to try and stimulate the economy. This could involve spending on welfare payments to help people who have lost their jobs, or cutting taxes.
- During periods of economic growth, governments may receive more tax revenue since consumers will be spending more and earning more. They may decide to spend less, since the economy does not need stimulating, and fewer people will be claiming benefits.

## Characteristics of a boom:

- High rates of economic growth
- Near full capacity or positive output gaps
- (Near) full employment
- Demand-pull inflation
- Consumers and firms have a lot of confidence, which leads to high rates of investment
- Government budgets improve, due to higher tax revenues and less spending on welfare payments

## Characteristics of a recession:

- In the UK, a recession is defined as negative economic growth over two consecutive quarters. The characteristics are:

- Negative economic growth
- Lots of spare capacity and negative output gaps
- Demand-deficient unemployment
- Low inflation rates
- Government budgets worsen due to more spending on welfare payments and lower tax revenues
- Less confidence amongst consumers and firms, which leads to less spending and investment