CONCEPT: INTRODUCING MACROECONOMIC CONCEPTS – SAVINGS AND INVESTMENT

● ***Savings*** – current consumption is _____________ current output

● ***Investment*** – current resources are devoted to _____________ future output

□ The term ***investment*** is different in economics from the definition you are used to:

Financial Investment:	Economic Investment:

● A firm's success is linked to making correct investment choices. Thus, firms must have ***expectations*** about the future.

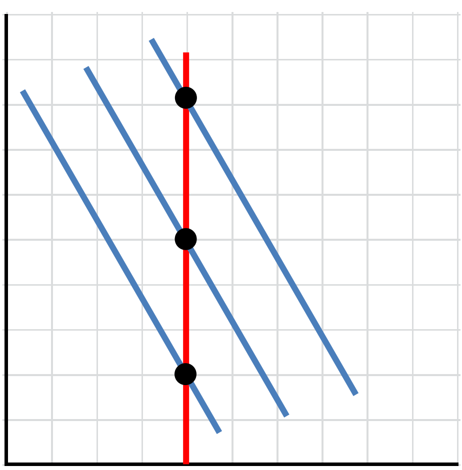
□ If firms become *pessimistic* about the future, it leads to less (1) current investment and (2) future consumption

□ If expectations of the future turn out to be incorrect, the economy must deal with ***shocks***:

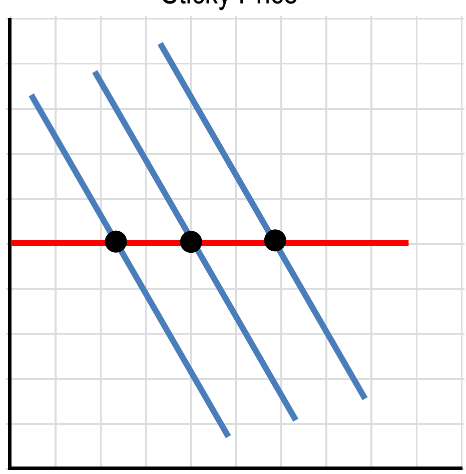
- ***Demand Shock –*** unexpected changes in the demand for goods and services
- ***Supply Shock –*** unexpected changes in the supply of goods and services

EXAMPLE: A chocolatier is considering opening a firm to sell chocolate. She makes predictions about the future, expecting to be able to sell 500 boxes of chocolate per week at a price of $20 per box. She calculates that each box would cost her $18 to produce, thus she can make a profit. She builds her factory and staffs it with workers to produce her optimal quantity of 500 boxes per week.

Flexible Price



Sticky Price



● ***Flexible prices*** allow the firm to continue producing at the optimum quantity while selling all production

□ No short-run fluctuations in output, unemployment levels would not change

● ***Sticky prices*** cause the firm to keep ***inventory*** if they will maintain the same level of production → _______________

□ Continuous low demand leads to a large inventory, thus leading to reduced output, and increased unemployment