

Notes — Week 4

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Period 3

1. GDP and Prices

- (a) Focus needs to be on growth not prices
- (b) To compensate, we use a price index
 - Choose a base year
 - Choose a market basket of goods and services
- (c) Consumer Price Index (CPI)
 - Thousands of consumer items
 - Base years 1982–1984 (average of those)
 - Compiled monthly
 - $CPI = \frac{y_{curr}}{y_{base}} \cdot 100$
- (d) Real vs. Current GDP
 - Nominal or current — Not adjusted for inflation
 - Real — Adjusted for inflation
- (e) GDP per capita is useful for comparison of countries
- (f) CPI vs. GDP Deflator

GDP Deflator	CPI
Ratio of nominal GDP to real GDP	Measure of a cost of a market basket of consumer goods
Counts all goods and services produced domestically	Counts all goods and services bought by consumers

- (g) GDP Deflator
 - $r_{GDP} = \frac{GDP_{nom}}{GDP_{def}} \cdot 100$
 - Any “real” calculation uses the simple formula $r_x = \frac{nominal}{index} \cdot 100$

(h) Inflation:

- Winners: Debtors
- Losers: Creditors

(i) Interest can be conceptualized as “rent” on money

(j) Interest rate formula:

- $nominal = real + inflation$