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:
   - $nominal = real + inflation$

2. Business Cycles

   - Regular and systematic fluctuations in the level of total output as measured in terms of real GDP
     - Recession — When real GDP declines for two quarters in a row
     - Expansion — Recovery from a recession
     - Business cycles are like earthquakes because:
       * It is known that they will occur
       * No one knows when they will occur
       * No one knows how intense they will be or how long they will last
   - Influences on Business Cycles:
     (a) Innovations
     (b) Monetary Factors
     (c) External Shocks

3. Unemployment

   - Unemploued — Not working at present, but have made an effort to find work in the last four weeks. Doesn’t account for “dropouts” or “discouraged” workers
   - Employed — Work for pay a minimum of one hour per week <u>or</u> without pay in a family enterprise a minimum of 15 hours
   - Unemployment Formulas:
     - Unemployment Rate: $\frac{Unemployed}{labor\ force}$
     - Labor Force: $employed + unemployed$
     - Labor Force Participation Rate: $\frac{labor\ force}{population_{16+}}$