# Chapter 21 – Monitoring Jobs and Inflation

**Employment and Unemployment**

**Why Unemployment Is a Problem**

Unemployment results in

Lost incomes and production

Lost human capital

**Labour Force Survey**

A survey done by Statistics Canada in which it asks 54,000 households.

Population is divided into two categories:

1. The **working-age population -** the total number of people aged 15 years and over
2. People too young too work (under 15 years of age)

The working-age population is again divided into two separate groups

1. People in the labour force
2. People not in the labour force.

The **labour force** is the sum of the employed and unemployed people.

Employed: Temporary layoff with an expectation of recall, without work but has made specific efforts to find a job within previous weeks, has a new job to start within four weeks

**The Four Labour Market Indicators**

*The Unemployment Rate:* Percentage of labour force that is unemployed

*The Involuntary Part-Time Rate (IPTR):* Percentage of the labour force who work part-time but want full time jobs

*The Labour Force Participation Ratio:* Percentage of Working age population who are members of labour force

*The Employment-to-Population Ratio:* Percentage of working-age population who have jobs

**Other Definitions of Unemployment**

The purpose of unemployment rate is to measure the underutilization of labour resources

Imperfect official measure as it excludes:

1. *Discouraged Searchers:* A discourages searcher is a person who is currently neither working nor looking for work but has indicated that is available for a job and has stopped because of repeated failure.
2. *Long-term Future Starts:*  A person with a job to start ion more than four weeks is not counted as unemployed
3. *Involuntary Part-timers:* Part-time workers looking for full-time jobs but can’t find them

**Unemployment and Full Employment**

*Frictional Unemployment:* Unemployment that arises from normal labour market turnover. Frictional unemployment is a permanent and a healthy phenomenon of a growing economy

*Structural Unemployment:* Unemployment created by changes in technology and international competition that change the skills needed to perform jobs or the locations of jobs. Unfortunately, it last longer than frictional unemployment

*Cyclical Unemployment:* IT is higher than normal unemployment at a business cycle trough and lower than normal unemployment at business cycle peak. It depends on recession cycle and expansion cycle.

**“Natural” Unemployment**

Natural unemployment is the unemployment that arises because of *frictional* and *structural* unemployment when there is no cyclical unemployment

**Full employment** is defined as the situation in which the unemployment rate equals the natural employment rate. At full employment, there is no cyclical unemployment

Key factors in unemployment rate:

1. *Age distribution of the population*
2. *The scale of structural change*
3. *The real wage rate*
4. *Unemployment benefits*

**Real GDP and Unemployment over the cycle**

Potential GDP is the quantity of real GDP produced at full employment. Potential GDP corresponds to the capacity of the economy to produce output on a sustained basis.

*Output Gap* = Real GDP – Potential GDP

If the output gap is positive then unemployment rate is lower than natural rate, whereas, If the output gap is negative, then unemployment exceeds the natural employment rate

**Price Level, Inflation, and Deflation**

**Price Level** is the average level of prices and the value of money

A persistent rise in price level is called *inflation* and persistent fall in price level is called *deflation.*

Inflation and deflation are not a problem when there is a low, steady, and anticipated form of either of these but a sudden change in them causes many different factors which are very noticeable and because of this we have:

Redistribution of income and wealth

Lowering in Real GDP and unemployment

Diversion of resources from production

At its worse, the inflation becomes ***hyperinflation,*** - an inflation rate that is so rapid that workers are paid twice a day because money loses its value so quickly. This is usually an inflation rate of 50 percent or higher a month.

**The Consumer Price Index**

The Consumer Price Index, or CPI, measures the average prices paid by urban consumers for a fixed basket of consumer goods and services and is calculated monthly by Statistics Canada.

Reading the CPI Numbers: The CPI for the reference base year is 100.

**Constructing the CPI**

*Selecting the CPI Basket:* The CPI Basket is based on a consumer expenditure survey conducted by the Statistics Canada.

*Conducting a monthly price survey:* Every month the prices are checked of these goods and the CPI is calculated.

*Calculating the CPI:*

1. Find cost of the CPI basket for reference base-period
2. Find cost of the CPI basket for the current-period
3. Calculate the CPI for the current period

**Measuring the Inflation Rate**

Major purpose of the CPI is to measure inflation rate

Inflation Rate: The percentage change in the price level from one year to the next

**The Biased CPI**

The CPI might overstate the inflation for four reasons:

1. *News goods bias:* There are always some goods which were not available in the previous years and hence if they are more expensive than the good they put an upward bias to the CPI
2. *Quality change bias:* Quality improvements occur every year and most of the price payed is for the improved quality and not the inflation.
3. *Commodity substitution bias:* Consumers’ substitutions for the same product is not considered and hence we can not explain the real inflation in price
4. *Outlet Substitution bias:* People switch the retailers giving them a cheaper product, but the CPI does not consider this substitution in calculating inflation rate.

*Estimates say that CPI overstates inflation by 0.6 percentage points a year.*

**Alternative Price Indexes**

There are alternative measures to price level such as

1. *GDP deflator:* A broader measure of the price level than the CPI because it includes all consumption expenditure, investment, government expenditure on goods and services and net exports.
2. *Chained Price Index for consumption:* An index of prices of all the items included in consumption expenditure in GDP.

**Core Inflation Rate**

An inflation rate excluding the volatile elements such as food and fuel. The most common measure of core inflation is core CPI inflation rate.