

Do Now

- ◆ List the 3 major goals of economic policymakers.
- ◆ What measures can we use to quantify the performance of the economy in these three areas?

Three Economic Policy Goals

- ◆ Economic Growth: Changes in **Real GDP** or **Real GDP per capita**.
 - ◆ Low Unemployment: **Unemployment rate**
 - ◆ Stable Prices: **Inflation Rate** (Changes in **Price Index**).
- *Examples of a price index include **CPI** and **GDP Deflator**.

	Nominal GDP	Cost of Market Basket	Price Index	Real GDP
Year 1	\$1,000	\$200		
Year 2	\$1,500	\$250		

- ◆ Year 1 is the Base Year for determining the price index.
- ◆ **Determine the Price Index and Real GDP for both years...**
- ◆ Find the inflation rate and rate of economic growth for Year 2.

	Nominal GDP	Cost of Market Basket	Price Index	Real GDP
Year 1	\$1,000	\$200	100	\$1000
Year 2	\$1,500	\$250	125	\$1200

- ◆ The inflation rate was 25% in Year 2.
- ◆ The rate of economic growth was 20% in Year 2 (use Real GDP to calculate)

- ◆ The price index for a country is 100 in the year 1995 and 200 in the year 2009. If nominal GDP is \$300 billion in 2009, what is real GDP in 2009 in 1995 dollars?

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Real GDP = (Nominal GDP / Price Index) x 100

Real GDP = (\$300 billion / 200) x 100

Real GDP = **\$150 billion**

- ◆ Suppose a typical household consumed the following items in the year 2003:

<u>Item</u>	<u>Quantity</u>	<u>Price</u>
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Food	5	\$20
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Clothing	4	\$25
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Cars	1	\$50
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What is the cost of the market basket in 2003?

If the market basket cost \$200 in the base year, what percentage did the CPI increase over the base year?

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What is the cost of the market basket in 2003? **\$250**

If the market basket cost \$200 in the base year, what percentage did the CPI increase over the base year?

$$(\$250 - 200) / 200 = 25\%$$

What is GDP?

◆ GDP = ?

◆ Expenditures approach formula:
GDP = ?

◆ Income approach formula:
GDP = ?

What is GDP?

◆ GDP = the sum of the money values of all final goods and services produced in the domestic economy within the year.

◆ Expenditures approach formula:

$$\mathbf{GDP = C + I_g + G + X_n}$$

◆ Income approach formula:

$$\mathbf{GDP = wages + rents + interest + profits + statistical adjustments}$$

Okun's Law

- ◆ Unemployment is currently at 6%. Assuming a 5% natural rate of unemployment, what is the gap between actual GDP and potential GDP?

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There is a 2% negative GDP gap.

Pillars of Growth

- ◆ Wealthy countries tend to have larger capital stocks, superior technology, and well-educated populations. This makes their labor forces very productive.
- ◆ However, wealthy countries tend to have *lower productivity growth rates* compared to poorer countries.

C, I, G, Xn, or Not in GDP?

A family pays \$75,000 for a house built three years ago.

What about the construction of a new house?

The government makes a \$300 Social Security payment to a retired person.

What about the government purchase of new radar equipment?

C, I, G, Xn, or Not in GDP?

- ◆ Packet: Lesson 2, Activity 12, Part B
 - #13. A family pays \$75,000 for a house built three years ago. **Not in GDP (second-hand sales contribute nothing to current production)**
 - What about the construction of a new house? **Investment**
 - #16. The government makes a \$300 Social Security payment to a retired person. **Not in GDP (Financial Transactions, including transfer payments, contribute nothing to current production)**
 - What about the government purchase of new radar equipment? **Government Spending**

Helped or Hurt by Unanticipated Inflation?

- ◆ People who borrow at fixed rates?
- ◆ People who lend at fixed rates?
- ◆ People who save with fixed rates of interest?

Helped or Hurt by Unanticipated Inflation?

◆ People who borrow at fixed rates?

Helped (Pays back the loan using dollars with less real value)

◆ People who lend at fixed rates?

Hurt (Borrower pays them back less valuable dollars than those loaned)

◆ People who save with fixed rates of interest?

Hurt (Rising prices decrease the real value/purchasing power of savings)

Frictional, Structural, Cyclical?

- ◆ An engineer is laid off due to a recession.
- ◆ A sales manager leaves his job in Idaho to look for work in New York.
- ◆ Automation makes a food packer's job obsolete.
- ◆ Which types are included in the natural rate of unemployment?

Frictional, Structural, Cyclical?

- ◆ An engineer is laid off due to a recession. **Cyclical**
- ◆ A sales manager leaves his job in Idaho to look for work in New York. **Frictional**
- ◆ Automation makes an food packer's job obsolete. **Structural**
- ◆ Which types are included in the natural rate of unemployment? **Frictional & Structural**