

Macroeconomics Exam 2 Study Guide

Chapter 7: Taking the Nation's Economic Pulse

1. **Gross Domestic Product (GDP):** the market value of all the final goods and services produced within a country during a specific period (usually a year)
 - a. **Market Value:** goods are weighed according to the purchase price of the good or service
 - i. Goods worth more add more to GDP
 - ii. Total spending on all goods and services produced during the year is summed to obtain GDP
 - b. **Final Goods and Services:** goods and services that are purchased by the ultimate user
 - i. **Intermediate Goods and Services:** goods purchased for resale
 - ii. **Avoidance of Double Counting:** intermediate goods are not counted in GDP because their value is calculated in the final good
 1. Ex: the production of bread
 - c. **Produced:** only goods and services that are produced or manufactured are counted in GDP, transfers are not
 - i. Financial transactions are NOT counted in GDP
 - d. **Within a Country:** counts only the goods and services produced within the geographic borders of a country
 - e. **During a Specific Period:** only goods produced in 2014 are included in the figure for 2014 GDP
 - i. Ex: How will a house produced in 2003 and resold in 2013 affect GDP in 2013?
 1. Sales commission, additions to the home, improvements
2. Ways to Measure GDP
 - a. Expenditure Approach
 - i. $Y=C+I+G+NX$
 1. $Y=GDP$
 2. $C=Consumption$
 - a. Household spending produced on goods and services during the current period (durable goods, non-durable goods, and services)
 3. $I=Investment$
 - a. The construction or production of capital goods that provide infrastructure
 4. $G=Government Consumption and Gross Investment$
 - a. Government spending on goods and services, capital goods
 5. $NX=Net Exports$
 - a. Exports (x) – imports (m)
 - b. Exports: domestically produced goods and services sold abroad

- c. Imports: foreign produced goods and services purchased domestically
 - b. Resource Cost-Income Approach
- 3. Limitations of GDP
 - a. Excludes nonmarket production
 - b. Excludes the underground economy: any transactions that take place outside recorded market channels (accounts for 10-15% of possible GDP)
 - c. Excludes leisure and human costs
 - d. Difficulty measuring quality variation and introduction of new goods
 - e. Excludes the costs of harmful side-effects
- 4. **Per Capita GDP= GDP/Population**
 - a. Per Capita GDP is a broad indicator of general living standards
- 5. **Gross National Product (GNP):** total market value of all final goods and services produced by the citizens of a country, no matter where they are geographically
 - a. Counts the income earned by Americans abroad
 - b. Ignores the income foreigners make in the abroad
- 6. Adjusting for Price Changes
 - a. **Nominal Values:** values expressed in current dollars
 - b. **Real Values:** values that have been adjusted for the effects of inflation
- 7. **Price Index (PI)**
 - a. Measures the cost of purchasing a market basket of goods at a point in time relative to the cost of purchasing the identical market basket during an earlier reference period
 - b. $PI = \frac{\text{cost of the bundle in the current year}}{\text{cost of the bundle in base year}}$
- 8. Key Price Indexes
 - a. **Consumer Price Index (CPI):** indicator of the general level of prices; compares the cost of a typical market basket in a specific period to the cost of the basket in a different period
 - i. Measures the impact of price changes on households
 - b. **GDP Deflator:** reveals the cost during the current period of purchasing the items included in GDP relative to the cost during the base year
- 9. Which PI should we use?
 - a. if you are measuring for households: use CPI
 - b. if measuring for the entire country: use the GDP deflator
- 10. Calculating Real Values
 - a. You need the nominal values and the price index for both the current year and the base year
 - b. Ex: real GDP
 - i. $GDP_{2013} = \$400, GDP_{2000} = \100
 - ii. $PI_{2013} = 2, PI_{2000} = 1$
 - c. $Real\ GDP_{2013} = Nominal\ Value_{2013} * \frac{PI_{2000}}{PI_{2013}}$

Chapter 8: Economic Fluctuations, Unemployment & Inflation

1. **Business Cycle:** fluctuations in the general cycle of economic activity

- a. **Expansion:** characterized by growing GDP and declining unemployment
 - b. **Peak (Boom):** the height of the expansion phase
 - c. **Contraction:** characterized by falling GDP and rising unemployment
 - d. **Trough:** the lowest point of the contraction phase
 - e. **Recession:** a decline in real GDP for two or more consecutive quarters
 - f. **Depression:** a prolonged and severe recession
2. Labor Market Definitions
- a. **Employed:** he or she worked full or part time in the past week or is on sick leave from a regular job
 - b. **Unemployed:** a person who is not currently employed but is (1) actively seeking employment in the last 4 weeks or (2) waiting to start or return to a job
3. Types of Unemployment
- a. **Frictionally Unemployed (U^F):** unemployment resulting from changes in the economy and imperfect information that prevents workers from being immediately matched up with existing job openings (not bad to an economist)
 - b. **Structural Unemployment (U^S):** unemployment due to structural characteristics of the economy that prevent the matching of available jobs with available workers
 - c. **Cyclical Unemployment (U^C):** unemployment due to recessions and inadequate labor demands
 - i. High during recessions, low or negative during expansions
 - d. **The Natural Rate of Unemployment (U^*):** the normal unemployment rate when the economy is operating at a sustainable rate of output
 - i. $U^* = U^S + U^F$
 - e. **Actual Rate of Unemployment (U):** sum of all three types of unemployment
 - f. **Full Employment:** occurs when the economy is experiencing the highest rate of output it can sustain
4. **Potential Output (Y^F):** the level of output that can be achieved and sustained in the future given (1) the size of the labor force, (2) expected productivity, (3) natural rate of unemployment
5. **Inflation:** an increase in the general level of prices (percent change)
- a. Causes the value of the dollar to decrease
 - b. Problems with inflation
 - i. Reduces investment
 - ii. Disrupts all the information delivered by prices
 - iii. Results in a less productive use of resources
 - c. What Causes Inflation?
 - i. Demand rising faster than supply
 - ii. Rapid increase in the money stock
 - d. **Hyperinflation:** inflation that is particularly severe and out of control
 - i. Ex: post WW1 Germany, Zimbabwe (2008)

Chapter 9

1. **The Labor Market**
- a. Price of labor is called wage (w)
 - b. Quantity of labor is called employment (E)