

Macroeconomics

Chapter 5: GDP

- **Macroeconomics** is the study of the nation's economy as a whole; focuses on the issues of inflation, unemployment, and economic growth.
- **Inflation** is sustained in the average prices of all goods and services.
- The **circular flow of production** and income - the circular flow shows how the production of goods and services generates income for households and how households purchase goods and services produced by firms.
- **Gross Domestic Product (GDP)** the total market value of final goods and services produced within an economy in a given year.
 - Total market value = #units x market price.
 - 2012 Nominal GDP = \$10Billion.
 - 2013 Nominal GDP = \$15Billion
 - the problem is we don't know the production combination.
 - Real GDP adjusts for inflation.
- **Intermediate goods** - goods used in the production process that are not final goods and services.
- **Real GDP** a measure of GDP that controls for the changes in price.
- **Nominal GDP** the value of GDP in current dollars.
- **Economic Growth** sustained increases in the real GDP of an economy over a long period of time.
- Economists divide GDP into four broad categories, each corresponding to different types of purchases represented in GDP:
 - $GDP (Y) = C + I + G + NX$
 - Consumption expenditures purchases of newly produced goods and services by households.
 - Durable Goods.
 - Non-Durable Goods (food, clothes)
 - Services (doctor)
 - Private Investment expenditures - purchases of newly produced goods and services by firms. (what businesses buy)
 - Gross Investment - depreciation = net investment
 - Government purchases - purchases of newly produced goods and services by local, state, and federal governments.
 - Transfer payments - payments from governments to individuals that do not correspond to the production of goods and services. Not included in GDP!
 - **Net Exports**
 - Imports - a good or service produced in a foreign country and purchased by residents of the home country.

- Export - a good or service produced in the home country and sold in another country.
- Trade deficit - excess of imports over exports.
- Trade surplus - excess of exports over imports.
- **National income** - the total income earned by a nation's residents both domestically and abroad in the production of goods and services.
- **Gross investment** total new investment expenditures.
- **Depreciation** - reduction in the value of capital goods over a one-year period due to physical wear and tear and also to obsolescence; also called capital consumption allowance.
- **Net investment** - gross investment minus depreciation.
- **Gross National Product (GNP)** GDP plus net income earned abroad.
- **Net exports** - exports minus imports.
- **Trade deficit** - the excess of imports over exports.
- **Trade surplus** - the excess of exports over imports.
- **Personal income** - income, including transfer payments, received by households.
- **Personal disposable income** - personal income that households retain after paying income taxes.
- **Value added** - the sum of all the income - wages, interest, profits, and rent - generated by an organization. For a firm, we can measure value added by the dollar value of the firm's sales minus the dollar value of the goods and services purchased from other firms.
- **GDP deflator** is an index that measures how the prices of goods and services included in GDP change over time.

$$\text{GDP Deflator} = \text{Nominal GDP} / \text{Real GDP} \times 100$$
- **Chain weighted index** - a method for calculating changes in prices that uses an average of base years from neighboring years.
- Fluctuations:
 - o **Recession** - commonly defined as six consecutive months of declining real GDP.
 - o **Peak** - the date at which a recession starts.
 - o **Trough** - the date at which output stops falling in a recession.
 - o **Expansion** - the period after a trough in the business cycle during which the economy recovers.
 - o **Depression** - the common name for a severe recession.
- Shortcomings of GDP as a measure of Welfare:
 - o Housework and Childcare.
 - o Leisure.
 - o Underground Economy.
 - o Pollution.

Chapter 5 Quiz

- The period of time in which the level of output moves from a trough to a peak is called recovery.
- If real GDP was 100 in 2011 104.4 in 2012, the growth rate of real GDP between 2011 and 2012 was 4.4%
- When GDP is measured in 'current prices' it is known as the nominal GDP.
- If an economy produces 220 pounds of jelly beans at \$5 per pound and 90 pounds of gum drops at \$2 per pound the real GDP was \$1280.
- Bananas, chocolate bars, chewing gum, orange juice and yogurt are considered to be nondurable goods.
- A trade surplus occurs when a country sells more abroad than it purchases from abroad.
- Transfer payments are excluded from government purchases in GDP accounting because nothing is being produced in return for the payment.
- GDP understands the value of output produced by an economy because it excludes value added from the underground economy, such as tips taken under the table.
- The circular flow is used to make the point that production generates income.
- How does real GDP differ from nominal GDP? Real GDP controls for price changes, while real GDP does not.
- A nation's net exports consist of its exports minus its imports.
- If in the third quarter of 2012 total investment spending was \$4768 billion and depreciation was \$3293 billion then the amount counted in GDP, which is known as gross investment, would be \$4768.
- A rancher raises sheep. One a year he shears them and sells the raw wool to a processor who cleans it and spins it into yarn. The yarn is then sold to a knitting mill, which produces and sells sweaters. In calculating GDP we would count only the sweaters.
- For the purposes of GDP accounting, government purchases include the purchases of new military equipment.
- Net investment is what is left over from total new private investment after depreciation.
- Exports increase GDP and imports decrease GDP.

Chapter 6: Unemployment and Inflation

- **Labor force** - the total number of workers, both the employed and the unemployed.
 - **The Unemployed** - individuals who do not currently have a job but are actively looking for work.
- UNEMPLOYMENT RATE = (unemployed/labor) force x100