Lecture 2: Basic Definitions

- GDP
- Inflation Rate
- Unemployment Rate
- Trade and Budget Deficits

Gross Domestic Product

- First thing we look at (its rate of growth)
- Aggregate output: Not easy!
 - Sum of apples and oranges
 - Double-counting
- Example

A Simple Economy

•	Steel C	Company	
	 Revenue from sales 		\$100
	Expenses (wages)		80
	– Profit		20
•	Car Cor		
	 Revenue from sales 	\$210	
	Expenses		
	• Wages	\$70	
	 Steel purchases 	100	
	– Profit		40
•	What is this econom	ıy's GDP?	

Calculating GDP

- Method 1: GDP is the value of the *final* goods and services produced by the economy during a given period
- Method 2: GDP is the sum of *valued added* produced....
- Method 3: GDP is the sum of *incomes* in the economy...

Nominal vs Real GDP

- Nominal GDP: sum of final goods produced times their *current price*
 - Growth due to quantity (production)
 - Growth due to prices
- Real GDP: ... times their base year price
- Example (next trp.)
- GDP Growth: (Y(t)-Y(t-1))/Y(t-1)

Nominal vs Real GDP

Year 0

	Q	P	Value
Potatoes	100,000	\$1	100,000
Cars	10	\$10,000	100,000
Nominal C	200,000		

Year 1

	Q	P	Value
Potatoes	100,000	\$1.2	120,000
Cars	11	\$10,000	110,000
Nominal C	230,000		

The Inflation Rate

- More than one.... (P(t)-P(t-1))/P(t-1)
- GDP deflator and CPI
- GDP deflator = Nominal GDP / GDP
 - P0 = 1
 - -P1 = 230,000/210,000 = 1.1 (approx.)
- NGDP growth = GDPg + Inflation (defl)
- 15 5 10
- Why do we care?

The Unemployment Rate

- Labor force (L) = Empl. (N) + Unemployed (U)
- Unemployment Rate (u) = U/L
- Willing to work? Looking for work? L < Pop.
 - Not in the labor force
 - Discouraged workers (recessions)
- High unemployment often comes hand on hand with low *participation rate*:
 - L/Pop of working age
- U.S. (u = 4%, pr = 80%) France (u=13%, pr = 65%)
- Why do we care? Too high and.... too low??

Deficits

- Expenditure > Income
- Trade Deficit:
 - Imports > Exports
 - U.S. today (FED, Treasury, Japan)
- Budget deficit
 - Gov. Expenditure > Gov. Revenue
- Why do we care? Smoothing; Argentina... the US

First Model: The Goods Market

