

Lecture 2: Basic Definitions

- Review Lecture 1
 - The U.S. (deficit/surplus; growth)
 - Europe (unemployment; EMU)
 - Japan (stock market; banks)
 - Emerging Markets (capital flows; complex international financial links)
- Current events (FT 09/12/99)

Today's plan: Basic Concepts

- 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 Company**
 - Revenue from sales \$100
 - Expenses (wages) 80
 - Profit 20
- **Car Company**
 - Revenue from sales \$210
 - Expenses
 - Wages \$70
 - Steel purchases 100
 - Profit 40
- What is this economy'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
- GDP Growth: $(Y(t) - Y(t-1)) / Y(t-1)$

The Unemployment Rate

- Labor force (L) = Empl. (N) + Unemployed (U)
- Unemployment Rate (u) = U/L
- Willing to work? Looking for work? $L < \text{Pop.}$
 - Not in the labor force
 - Discouraged workers (recessions)
- High unemployment often comes hand on hand with low *participation rate* :
 - $L/\text{Pop of working age}$
- 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; Brazil

First Model: The Goods Market

