#### Lecture 2: Basic Definitions

• Econ NEWS... to be filled

# 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
  Expenses (wages)
  Profit
- Car Company
- Revenue from sales
- Expenses
  - Wages \$70
  - Steel purchases 100
- Profit
- What is this economy's GDP?

\$210

40

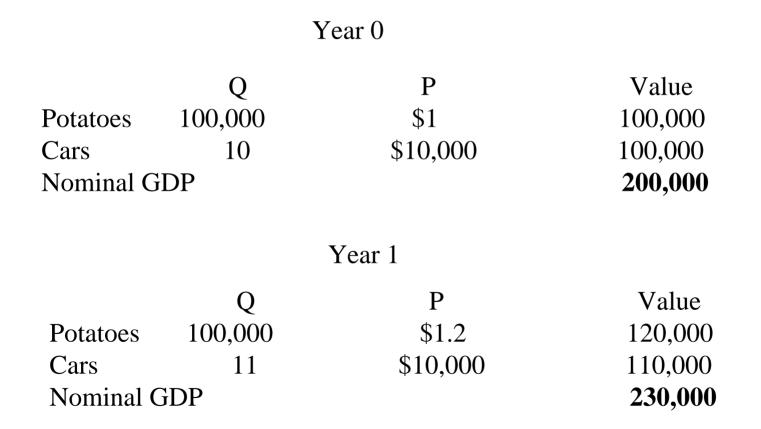
# Calculating GDP

- 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



## 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

