Chapter 5, Inflation and Unemployment

I. Introduction: The Macroeconomy
   A. GNP/GDP, National Income, Disposable Income, Per Capita Income
   B. Growth, Recession, Depression, Expansion
   C. Employment, Unemployment, Unemployment rate
   D. Inflation, CPI, PPI
   E. Interest rates: Prime, Mortgage, T-Bill, Federal Funds; Rates of Return (ROR)
   F. Trade Balance: Imports, Exports, Exchange Rates

II. Inflation
   A. The Inflation Rate
      1. Price index: an aggregate, weighted average of a set of prices. The aggregation is across all items to be considered. The weighting is according to “importance”.
         a. Consumer Price Index (CPI): Aggregation across all items that a typical household would normally consume, weighted by share of expenditures in a typical budget.
         b. Producer Price Index (PPI): Similar to above, except for firms and their costs of production (that is, we use resource/inputs prices).
         c. The GDP Deflator (uses total value of economic activity,....)
         d. Dow Jones Index uses stock values for 30 large companies.
         e. Your semester GPA is an index. If you had 2 A’s, 2 B’s and 1 C in five 3-hour courses, 40% of your grade is A, 40% of your grade is B, and 20% is C, so your GPA is calculated as: \[0.4 \times 4.0 + 0.4 \times 3.0 + 0.2 \times 2.0 = 1.6 + 1.2 + 0.4 = 3.2\]
      2. Calculation of the CPI
         a. Determine a “base year” (a standard for comparison) and calculate the total dollar expenditure for a “basket of goods and services” for that year.
         b. For the current year, do the same (“buy” the same market basket).
         c. Divide current year by base year and multiply by 100.
            1) Note that the value for the CPI in the base year is 100.
            2) U.S. CPI currently uses 1982-1984 (average) as the base year (p 117)
      3. Calculating percent changes in the CPI give us the inflation rate
         a. Pick a “common” date for each year, typically December 31 (or mid-year)
         b. Inflation in 2000 = \[\frac{(CPI2000-CPI1999)}{CPI1999} \times 100\]
         c. Inflation in 1990s = \[\frac{(CPI1999-CPI1989)}{CPI1989} \times 100\]
   B. Inaccuracy of the Inflation Rate
      1. Changes in the market basket
         a. Tastes change....!
         b. The substitution bias (substitute away from high-price goods)
         c. For (c), use a “chain-weighted” price index (disregard for our class)
      2. Changes in quality
      3. Changes in outlets (how goods and services are sold / delivered)
   C. Using the inflation rate
      1. Inflation and real incomes: Is your income keeping up with inflation?
      2. Prices (or incomes) then and now.... “Why I remember when....”!!
D. The Effects of Inflation
   1. Redistribution
   2. Uncertainty: Inefficiency and Risk Aversion
   3. Menu Costs
   4. International Effects

E. Types of Inflation
   1. Cost-push
   2. Demand pull

III. Unemployment
A. The Unemployment Rate
   1. Calculated as (# Unemployed / # in Civilian Labor Force) * 100
   2. Who is “unemployed” and who is “employed”
      a. You are not in the CLF if you are under 16, in the military, in an institution”, or
         you have voluntarily elected not to be a part of the work force (student, retiree,
         homemaker, etc.)
      b. You are in the work force if you work full- or part-time or are self-employed.
      c. You are unemployed if you don’t have a job and you are actively seeking work.
      d. Civilian Labor Force = Employed + Unemployed
   3. There is also an “employment rate” and a “labor force participation rate”

B. Classifying the Unemployed
   1. Unemployed = Job loser + Job leaver + Reentrant + New entrant
   2. Discouraged workers are NOT unemployed

C. The Data
   1. The National Unemployment Rate
   2. Unemployment Rates for Selected Groups of People

D. Types of Unemployment
   1. Frictional Unemployment
   2. Structural Unemployment
   3. Cyclical Unemployment

E. Natural Rate of Unemployment is Frictional plus Structural

F. Full Employment
   1. When Unemployment rate = Natural Rate of Unemployment
   2. When Cyclical unemployment = zero

IV. Job Search Theory
A. Wage Offer Curve: You don’t take the first job you are offered...
B. Reservation Wage Curve: Your reservation wage decreases over time.
C. Optimal Search Time
D. Optimal Search Time and the Unemployment Rate