**Practice with GDP, Unemployment and Inflation**

**WHAT IS COUNTED AS GDP? USE “Y” FOR YES and “N” FOR NO.**

1.\_\_No\_\_ A monthly check received by an economics student who has been granted a scholarship.

Excluded: transfer payment from government to an individual

2.\_Y\_\_\_ The purchase of a tractor by a farmer.

Included: business fixed investment

3.\_\_N\_\_ The purchase of a second-hand tractor by a farmer.

Excluded: Was already counted in a previous years GDP.

4.\_\_N\_ Proceeds from cashing in a US savings bond

Excluded: Bond is a financial asset.

5.\_\_N\_\_ The services of a mechanic in fixing the radiator on his own car.

Excluded: This is a nonmarket activity

6.\_\_\_\_ Old age and survivor’s insurance check received by a retired store clerk

7.\_\_\_\_ An increase in business inventories

8.\_\_\_\_ Government purchases of parts of nuclear missiles

9.\_\_\_\_ The income of the barber who cuts your hair

10.\_\_\_ Income received from redeeming coupons on an AT&T bond

11.\_\_\_ Cash received from the sale of an AT&T bond

12.\_\_\_ The purchase of Van Gogh’s painting by an art dealer.

**WHICH SECTOR OF GDP? USE “C” FOR CONSUMPTION, “I” FOR BUSINESS INVESTMENT, “G” FOR GOVERNMENT, “NX” FOR NET EXPORTS AND “NC” FOR NOT COUNTED.**

13.\_C\_ $5 you spend to see a movie

14.\_I\_You pay $100,000 to a contractor for a home you built this year.

15.\_NC\_ You pay the bank the remaining amount of your mortgage for a home constructed 5 years ago.

16.\_C\_ You pay a tailor $275 for making a suit.

17.\_G\_ The government increases its military expenditures by $3 billion.

18.\_NC\_The government makes a $200 Social Security payment to a retired person.

19.\_C\_You buy 1000 shares of General Motors stock for $5378 including a broker’s fee of $378.

20.\_I\_\_At the end of the year, a flour-milling firm finds that its inventories of grain and flour are $10,000 above the amounts of it inventories at the beginning of the year.

21.\_NC\_A housewife does a lot of work caring for her husband and two kids.

22.\_I\_General Motors buys new robots for its factory at Wentzville.

23.\_C\_ You pay $300 a month to rent a house.

24.\_\_Apple Computer builds a new factory in Mexico.

25.\_NC \_ R.J. Reynolds Company buys control of Nabisco Brands cookies.

26.\_C\_You buy a new Toyota that was built in Ohio.

27.\_C\_You pay tuition to attend Georgia Southern University.

28.\_NX\_You buy a new Honda that was built in Japan.

**WHO IS HURT AND WHO IS HELPED BY UNANTICIPATED INFLATION? CIRCLE THE LETTER THAT BEST FITS EACH SCENARIO, THEN EXPLAIN YOUR ANSWER.**

**“H” REPRESENTS PERSON/GROUP IS HURT**

**“G” REPRESENTS PERSON/GROUP IS HELPED OR GAINS.**

**“U” MEANS IT IS UNCERTAIN IF PERSON/GROUP IS AFFECTED OR IF EFFECTS ARE UNCLEAR.**

29. Banks extend many fixed-rate loans. **H** G U

Explanation: The money the bank receives for the loan repayment will be less in real terms (purchasing power) than the loan amount.

30. A state government receives revenue mainly from a progressive income tax. H G **U**

Explanation: It depends on how much tax revenue increases relative to inflation.

31. A widow lives entirely on income from fixed-rate corporate bonds. **H** G U

Explanation: The purchasing power of the income will be less as inflation continues to deflate the value of the dollar.

32. A farmer buys machinery with a fixed-rate loan to be repaid over a 10-year period. H **G** U

Explanation: Farmer makes payments that are less in real terms than the loan amount.

33. Your family buys a new home with an adjustable-rate mortgage. H G **U**

Explanation: It depends on what happens to the future interest rate relative to the inflation rate. If the real interest rate rises, the family will be furt.

34. Your savings from your summer job are in a savings account paying a fixed rate of interest. **H** G U

Explanation The return from savings will be worth less because of inflation and the fixed rate of return.

35. A retired man lives entirely on income from Social Security. H G **U**

Explanation: It depends on whether the Social Security payments are fully indexed for inflation. If Social Security payments do not increase at the same rate as inflation, then the retired man is hurt by inflation because he cannot purchase the same amount of goods and services.

36. A retired couple lives entirely on income from a pension the woman receives from her former employer. H G **U**

Explanation: It depends on whether the pension has a cost-of-living adjustment. If it does not, then the purchasing power of the pension payment will be less as inflation continues.

37. The federal government has a $12,000,000,000 debt. H **G** U

Explanation: The government will repay the debt with money that has less purchasing power.

38. What conclusions can you draw about who is helped and who is hurt by unanticipated inflation? Individuals who receive fixed incomes are hurt by inflation—for example, lenders and savers. People who make fixed payments gain—for example, borrowers.

**FOR EACH OF THE FOLLOWING SITUATIONS, PUT THE APPROPRIATE LETTER BEFORE THE EXAMPLE.**

**F** IF IT IS AN EXAMPLE OF FRICTIONAL UNEMPLOYMENT.

**C** IF IT IS AN EXAMPLE OF CYCLICAL UNEMPLOYMENT.

**S** IF IT IS AN EXAMPLE OF STRUCTURAL UNEMPLOYMENT.

\_S\_1. A skilled glass blower becomes unemployed when a new machine does her job faster.

\_C\_2. Workers are laid off when the local manufacturing plant closes because the product made there isn’t selling.

\_C\_3. A computer programmer is laid off because of a recession.

\_F\_4. A literary editor leaves her job in New York to look for a new job in San Francisco.

\_S\_5. A high school graduate lacks the skills necessary for a particular job.

\_F\_6. An unemployed college graduate is looking for his first job.

\_F\_7. An individual refuses to work for minimum wage.

\_C\_8. Slumping sales lead to the cashier being laid off.

TEST YOUR UNDERSTANDING OF MACROECONOMIC INDICATORS: ANSWER THE QUESTIONS ABD BRIEFLY EXPLAIN YOUR ANSWERS.

1.The unemployment rate and employment both go up. Ellen says that it is not possible for both to rise at the same time. Is Ellen correct or incorrect? Why? Ellen is incorrect. If more people enter the labor force and most of them do not find jobs, both employment and unemployment rates will rise.

2. True, false or uncertain, and explain why? “Gross domestic product measures the amount of wealth in the economy.”

False. GDP measures a stream of production or income in a particular year or time period. Wealth includes the current value of goods and services produced in past years.

3. True, false, or uncertain and explain why? “A decrease in gross domestic product must reduce a person’s standard of living.”

False. GDP measures the production of the nation. Even during recessions, many people’s real incomes rise.

4. True, false, or uncertain and explain why? “If nominal GDP increases by 5% and the price level increase by 7%, real GDP has decreased.”

True. Real GDP would fall by about 2 % because the inflation rate is higher than rate of growth in nominal GDP.

5. True, false or uncertain, and explain why? “Frictional and structural unemployment are two words for the same thing.”

False. Structural unemployment occurs because people do not have the skills necessary for the jobs available. Frictional unemployment occurs when people are between jobs. They will find employment, but it will take time to match them with job vacancies.

6. Why does unanticipated inflation help borrowers and hurt lenders?

Borrowers pay back a fixed number of dollars, but these dollars are worth less. This means that the purchasing power of the dollars that lenders receive is lower than the purchasing power of dollars in the original loan. If the loan has a variable interest rate and inflation causes nominal interest rates to rise, the lender will not be hurt as badly because the lender can raise the interest rate on the loan.

7. True, false or uncertain, and explain why? “If the economy is at full employment, the unemployment rate is zero.”

False. At full employment, we have frictional and structural unemployment. Frictional unemployment occurs when people are between jobs; structural unemployment occurs when people do not have skills for the jobs that are available.

Multiple Choice

1. D

2. C

3. C

4. D

5. B

6. A

7. E

8. B

9. A

10. C

11. B

12. D

13. C

14. A

15. B

16. D

17. A

18. A

19. A

20. A