

Introduction to Macroeconomics · M5 · 2014-15

Problem set 1 · Exercises

1. Nominal GDP, real GDP, GDP deflator. There are only two goods. Fill out the following table, providing a justification for each answer.

period	1	2	3
price p_1 of good 1	8	3	
amount q_1 produced of good 1	5		2
price p_2 of good 2		5	
amount q_2 produced of good 2		8	2
nominal GDP	100		60
real GDP (base period $t = 1$)		80	
GDP deflator (base = 100)			300
GDP deflator inflation rate			

2. Real GDP. There are only two goods. The following table shows the price, and amount produced, of each good in each period.

t	p_1	q_1	p_2	q_2
1	4	6	2	8
2	9	x	3	y

- With $y = 5$, find out the value of x (that is, the amount of production of good 1 in period 2) ensuring that GDP at constant prices of period 1 remains unchanged from $t = 1$ to $t = 2$.
- Answer (i) again if the aim is to keep GDP at constant prices of period 2 unaltered.
- If $x = 5$, calculate the value of y (the amount of production of good 2 in period 2) guaranteeing that GDP at constant prices of period 1 remains unchanged from $t = 1$ to $t = 2$.
- Letting $x = y$, which is the smallest value of x under which GDP at constant prices of period 1 increases from $t = 1$ to $t = 2$?

3. Real GDP. Can real GDP increase from t to $t + 1$ if the production of all the goods remains constant from t to $t + 1$?

4. Manipulating real GDP? There are only two goods. The following table shows the price, and amount produced, of each good in each period. Verify if there is some value of x such that a change in the base period modifies the period with the largest real GDP.

t	p_1	q_1	p_2	q_2
1	4	6	2	8
2	x	9	3	5

5. Redefining real GDP. There are only two goods. The following table shows the price, and amount produced, of each good in each period. Real GDP with base period $t = 1$ values production of every period by means of the price vector $(p_1^1, p_2^1) = (4, 2)$ from $t = 1$. Real GDP with base period $t = 2$ values production of every period by means of the price vector $(p_1^2, p_2^2) = (3, 3)$ from $t = 2$. Consider a new definition of real GDP in which the price vector adopted to give value to production is the combination of the previous two price vectors: $\lambda \cdot (4, 2) + (1 - \lambda) \cdot (3, 3)$. The parameter λ represents the weight attributed to the prices from period $t = 1$ and satisfies the constraint $0 \leq \lambda \leq 1$.

t	p_1	q_1	p_2	q_2
1	4	7	2	8
2	3	9	3	5

- What does the case $\lambda = 0$ represent? And the case $\lambda = 1$?
- Computing every real GDP with the price vector $\lambda \cdot (4, 2) + (1 - \lambda) \cdot (3, 3)$, find the value λ' of λ that equates real GDP from $t = 1$ with real GDP from $t = 2$.
- Being λ' the value computed in (ii), which period has the largest real GDP if $\lambda < \lambda'$?
- In view of the preceding analyses, is it defensible the existence of a “correct” value for real GDP?

6. GDP growth. The GDP of economy 1 is 1000. The GDP of economy 2 is 20. (i) Economy 1 grows at an annual rate of 2%. Economy 2's rate is 12%. How many years are roughly necessary for the GDP of economy 2 to catch up with the GDP of economy 1? (ii) If economy 1 grows at 5% per year, what is the smallest growth rate that allows economy 2 to catch up with economy 1 in 10 years?

7. GDP and GDP deflator. For every period t , calculate: (i) nominal GDP; (ii) real GDP at constant prices of period $t = 2$; (iii) the corresponding GDP deflator; (iv) the rates of growth of both nominal GDP and real GDP; and (v) the GDP deflator inflation rate.

t	p_1	q_1	p_2	q_2	p_3	q_3
1	5	1	6	4	0	0
2	6	2	3	3	1	2
3	5	3	5	2	2	4
4	3	4	9	1	3	6

8. Rule of 70 (Rule of 72). If a variable grows at a rate of g per cent per year, it doubles approximately every $70/g$ ($72/g$) years. Compute how many years are roughly necessary for a variable growing at the following rates to double using both rules.

rate (%)	years	rate (%)	years	rate (%)	years
1/10		3		7	
1/5		4		10	
1		5		50	
2		6		100	

9. CPI. Imagine an economy where only two goods are produced, good 1 and good 2. The basket of goods associated with the CPI consists of one unit of good 2 and two units of good 3, which is an imported good. Given the table below, find: (i) for each period, the GDP deflator with base level 100; (ii) for each period, and also with base level 100, the CPI; (iii) the inflation rates based on GDP deflator; and (iv) the inflation rates corresponding to the CPI.

period	p_1	q_1	p_2	q_2	p_3	q_3
1	5	100	1	400	6	100
2	4	100	2	300	7	200
3	3	100	3	200	6	150
4	2	100	2	100	8	300
5	1	100	1	300	7	250

10. GDP. What happens to the GDP deflator if nominal GDP and real GDP are both increased twofold?

11. CPI. (i) Is a negative CPI possible? (ii) If so, what would a negative CPI mean?

12. GDP deflator. Find the approximate value of the GDP deflator inflation rate if real GDP has increased by 10% and nominal GDP has fallen by 5%.

13. Real and nominal GDP. (i) Can real and nominal GDP be equal at a period t different from the base period? (ii) If so: (a) what would it mean?; (b) could real GDP at that period t be larger than real GDP at the base period?; (c) could nominal GDP ?

14. Real and nominal variable. The following table displays the monthly minimum (nominal) wage in Spain (in euros) and the CPI (annual average). Compute: (i) for each year, the monthly minimum real wage; (ii) the sequence of growth rates of the nominal wage; and (iii) the sequence of growth rates of the real wage. (iv) Optional: draw a chart with the results.

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
wa ge	44 2.2	451 .2	46 0.5	513	54 0.9	570 .6	60 0	62 4	63 3.3	641 .4	641 .4	645 .3	645 .3
CPI	78. 66	81. 02	83. 50	86. 33	89. 31	91. 90	95. 46	95. 26	97. 06	10 0.1	102 .58	103 .89	103 .89

<http://www.ine.es/jaxiBD/tabla.do?per=01&type=db&divi=IPC&idtab=109>

<http://www.salariominimo.es/> (2015: 648.60 EUR)

15. Real and nominal GDP. Consider two periods of an economy with two goods. Find the prices and the quantities of the goods so that from period 1 to period 2 nominal GDP falls and real GDP rises.

16. Real and nominal consumption. What can be inferred from having a nominal consumption larger than the real consumption?

17. CPI and GDP deflator. (i) Explain the differences between the GDP deflator and the CPI. (ii) Identify two differences between real GDP and CPI. (iii) Can the CPI inflation rate be positive and, simultaneously, the GDP deflator inflation rate be negative? (iv) What is the effect of a change in the price of imported goods on: (a) CPI; (b) GDP deflator?

18. Rates of change. For any given variable v , let \hat{v} designate the rate of change of v : absolute change $v_1 - v_0$ in v divided by the initial value v_0 . (i) Compute the relative error that arises when the correct rate of change of the variable $z = x \cdot y$ is approximated by the rule $\hat{z} \approx \hat{x} + \hat{y}$ [the correct value is given by $1 + \hat{z} = (1 + \hat{x}) \cdot (1 + \hat{y})$]. (ii) Do the same when the correct rate of change of the variable $z = x/y$ is approximated by the rule $\hat{z} \approx \hat{x} - \hat{y}$. (iii) Find the formula of the correct value in (ii).

period	\hat{x}	\hat{y}	value of \hat{z} using the rule	correct value of \hat{z}	relative error (%)
1	1%	1%			
2	1%	10%			
3	1%	100%			
4	10%	-20%			
5	10%	20%			
6	0%	100%			

19. GDP, GDP deflator. Identify which of the following cases are possible and which are not.

Case	Nominal GDP	Real GDP	GDP deflator
1	increases	increases	increases
2	increases	decreases	decreases
3	decreases	decreases	increases
4	decreases	increases	decreases
5	decreases	increases	does not change
6	does not change	increases	decreases

20. GDP growth. (i) Can it be that the nominal GDP of an economy grows faster than the nominal GDP of a second economy and, simultaneously, that the real GDP per capita of the second economy grows faster than the real GDP per capita of the first economy? (ii) What if “nominal” were replaced by “real”?

21. GDP, GDP deflator, CPI. (i) If nominal GDP and real GDP both fall at the same rate, what is the value of the GDP deflator? (ii) And the GDP deflator inflation rate? (iii) And the CPI inflation rate?

22. Real GDP growth. Find the approximate value of real GDP growth if the GDP deflator inflation rate is 5% and nominal GDP growth is -5%.

23. Inflation rate. Find the approximate value of the inflation rate if real GDP has increased by 4% and nominal GDP has decreased by 2%.

24. GDP, GDP deflator, GDP per capita. Complete as much as possible of the following table.

Case	Nominal GDP growth rate	GDP deflator inflation rate	population growth rate	Real GDP per capita growth rate
1	positive	positive	positive	
2		negative	positive	zero
3	negative		negative	positive
4			zero	zero
5	zero	negative	positive	
6		zero	negative	negative
7	zero	positive	zero	
8		positive		positive

25. GDP deflator. Nominal GDP in period 3 is 100. Real GDP in period 3 is 120. (i) Compute the GDP deflator inflation rate from period 2 to period 3. (ii) If, in period 2, nominal GDP was higher than real GDP, was the GDP deflator inflation rate positive or negative? Explain the answer.

26. Inflation rates. If the GDP deflator inflation rate rises, what happens necessarily with the CPI inflation rate?

27. Macroeconomic identities. (i) Define net private saving as $S - I$ and the government budget as $G + TR - T$. If both magnitudes double, what happens to the trade balance NX ? (ii) If net private saving is positive and the trade balance negative, is there a budget deficit or a budget surplus?

28. Macroeconomic identities. With the help of the fundamental macroeconomic identities, find net exports if the government budget (spending minus revenue) is equal to net exports, savings are three times investment, and investment is 10.

29. Macroeconomic identities. Using the fundamental macroeconomic identities, establish if investment I increases, decreases, or does not change if the trade balance raises, the government budget (spending minus receipts) falls and private savings S is always zero.

30. GDP, CPI. Fill out the table in a justified way if the two goods are produced in the economy and the CPI basket is $(q_1, q_2) = (1, 4)$.

period	1	2	3
price p_1 of good 1		10	
amount q_1 produced of good 1	10		30
price p_2 of good 2			20
amount q_2 produced of good 2	20	40	
nominal GDP		2000	2000
real GDP (base period $t = 1$)	1000	2000	
GDP deflator (base = 100)			
GDP deflator inflation rate			
value of the CPI basket	200		160
CPI (base period $t = 1$ · base level = 100)			

31. Macroeconomic identities. Fill out the following table (where government budget is defined as spending minus receipts).

Case	Net private saving	Government budget	Trade balance
1	positive	positive	
2		negative	positive
3	negative		positive
4			zero
5	zero	negative	
6		zero	

32. Definitions. (i) For each of the following pairs of concepts, identify a common feature: (1) inflation / disinflation; (2) deflation / disinflation; (3) inflation / deflation; (4) real GDP / nominal GDP per capita; (5) inflation rate according to the CPI / GDP deflator; (6) stock variable / nominal variable; (7) potential GDP / GDP at constant prices; (8) core inflation rate / wealth; (9) inflation rate / GDP growth rate; and (10) CPI inflation rate / CPI. (ii) For each pair, identify a differentiating feature.

33. Macroeconomic identities. Show how to obtain the identity $\mathbf{I} \equiv \mathbf{S} + (\mathbf{T} - \mathbf{TR} - \mathbf{G}) + (\mathbf{IM} - \mathbf{EX})$ from the identity $\mathbf{Y} \equiv \mathbf{C} + \mathbf{I} + \mathbf{G} + \mathbf{NX}$.

34. Macroeconomic identities. Defining net private saving as $\mathbf{S} - \mathbf{I}$, identify which of the following cases are possible and which are not (where government budget is defined as spending minus receipts).

Case	Net private saving	Government budget	Trade balance
1	rises	rises	rises
2	rises	falls	does not change
3	falls	does not change	rises
4	falls	rises	falls
5	falls	rises	does not change
6	does not change	rises	falls

35. Macroeconomic identities. Using the macroeconomic accounting identities, find net exports (\mathbf{NX}) if $\mathbf{S} = 50$, $\mathbf{G} = 20$, $\mathbf{TR} = 5$, and $\mathbf{T} = 30$.

36. Real and nominal GDP. Draw a graph such that: (i) nominal GDP and real GDP both grow with time; (ii) initially, real GDP is larger than (lies above) nominal GDP; (iii) at a certain point t^* in time, nominal GDP equals real GDP; (iv) after t^* , nominal GDP remains always larger (is above) real GDP. (i) Does t^* have any special meaning? (ii) What information furnishes the fact that nominal GDP is above real GDP after t^* ? (iii) And the fact that nominal GDP is below real GDP before t^* ? (iv) Answer questions (ii) and (iii) if the curves representing real GDP and nominal GDP were mutually exchanged.

37. Macroeconomic identities. Using the fundamental macroeconomic identities, ascertain whether exports are higher than, smaller than, or equal to investment if: imports equal government expenditure; transfers equal taxes; and investment is half savings.

38. GDP per capita. Take a look at the charts on real GDP per capita that can be found at the course web page. Consider the chart representing real GDP per capita in the period 1846-2008 for USA, BEL, ESP, BRA, and SVK. (i) Make a rough estimate of the number of years that, in 2008, BEL, ESP, BRA, and SVK lagged USA in real GDP per capita. (ii) Determine, for each of the four countries, whether the time lag with respect to USA has, since Second World War, widened or shrunk. (iii) What is the maximum time lag between any two countries? (iv) When did BRA reach the real GDP per capita level that BEL enjoyed in 1846?

39. Suggest three new multiple choice questions.