**What has happened to the value of our money?**

* The dollar has lost \_\_\_\_% of its value since 1992.
* Or, a dollar today will buy the same amount of stuff as $0.64 would buy in 1992.

**Inflation:**

* Inflation: P , $ value
* Deflation: P , $ value
* Stagflation: recession + inflation at same time.
* For the last 50 years, the U.S. has had an avg. inflation rate of 4% /yr.

**So let’s say:**

* You get a raise of 5% this year.
* But inflation was 5% this year.
* Your nominal pay rose.
* What happened to your PURCHASING POWER???
* IT STAYED THE \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Unexpected Inflation:**

* Hurts:
  + lenders at fixed rates
  + savers at fixed rates
  + fixed-income recipients
* Benefits:
  + borrowers at fixed rates

**Reminders/Hints:**

* A bond is a loan.
  + If I buy a bond from Coca-Cola, I’m loaning them $.
  + They sold me a bond, so they’re borrowing from me.
* Dividends are \_\_\_\_\_\_\_\_\_\_\_\_\_ paid to stockholders. When prices rise, dividends rise.
* Income tax is a percentage of your income.
  + When prices rise, incomes rise.

**Causes of Inflation:**

* Increase in money supply (MV=PQ)
* War
* More demand
  + When prices rise, incomes rise.

**Constructing a Price Index:**

* Inflation can distort GDP from year to year.
* A \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ measures P changes.
* Select goods & services for a “market basket.”
* Add the price of each of these goods, to get the “base-year market basket price.”
* Find the market basket price at regular intervals (monthly, yearly, etc.).

**Math Review:**

* Percent Change
* the formula: [(new-old)/old] X 100
* so if something increases from 5 to 7, the percent change is
* [(7-5)/5] = 0.4 = 40%

**Constructing a Price Index-Continued:**

* Price index =
* (selected basket price/ base yr. basket price)X100
* The base-year price index always = 100!
* Inflation =
* % change in price index, [(new-old)/old]

**Major Price Indexes:**

* Consumer Price Index (CPI)-90,000 items in 364 categories.
* Implicit GDP Price \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_- *all* goods/services. Base year 1996.

**I. Real GDP**

* GDP adjusted for inflation.
* Real GDP=
* [GDP from year Y/(price index from year Y)]X100
* This formula sets dollars equal to base year.
* Listen:
* If GDP in 2003 was $10.6 trillion, and the GDP deflator was 111.9, what was the Real GDP?
* [$10.6 trillion/111.9]X100= $9.5 trillion
* $9.5 trillion is 2003 GDP measured in 1996 prices.

**Causes of Inflation:**

* Demand-pull inflation
* Cost-push inflation - during \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
* Growth in money supply.
* Wage-price spiral - higher Ps, then higher wages, then higher Ps...

**Inflationland:**

* In Inflationland, they have inflation at the relatively high rate of 7% a year.
* The inflation rate is always 7%.
* Banks expect inflation to stay at 7%, and make decisions accordingly.
* Businesses give all workers a 7% raise every year.
* The government raises taxes 7% every year.
* Who does inflation hurt in this country????