

EC1010: Tutorial Questions 1

January 30, 2010

1. Suppose prices are stable over time. In such an environment, what is the relationship between real and nominal GDP growth? What is happening to the CPI?
2. Consider the following statements
 - (a) On November 26th, the *Economist* magazine wrote the following about Japan:

“In the third quarter, GDP grew at a quarterly rate of 1.2 percent in real terms, the fastest growth in the G7, but in nominal terms....it fell by 0.1 percent.”
 - (b) A well-known economist, Paul Krugman, wrote last week:

“the economists at Goldman Sachs are now predicting 5.8 percent real GDP growth in the fourth quarter. But they also say that the headline number will be highly misleading: two-thirds of the growth will be an inventory bounce, with final demand growing only 2 percent. In short, it will be a blip.”

 1. In Japan, explain why real GDP rose, while nominal GDP fell.
 2. Explain why the economists at Goldman Sachs believe the GDP data is misleading about the extent of economic recovery.
3. Use Figure 1 below to answer the following questions:
 - (a) What is the approximate percentage increase in production in the U.S. economy over the period 1991 to 2010?
 - (b) Has there been an increase in the standard of living in the U.S. over this period?
 - (c) Over this time period, many U.S. corporations set up business abroad in countries such as Ireland. What effect would this have on the level of GNP relative to GDP in the U.S. over this time period?
 - (d) From the graph, it is clear that Japanese actual GDP equaled potential GDP in 1993. Yet, although real GDP rose in Japan from 1993 to 2006, for most of the period, it has a negative output gap. What can we infer about potential output in Japan over this period?
4. Recently, there was an earthquake in Haiti. How would this development affect potential GDP in Haiti?

Problem Set 1

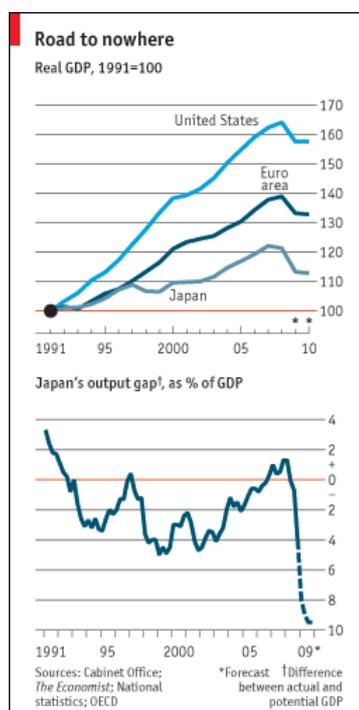


Figure 1: REAL GDP IN VARIOUS REGIONS AND THE OUTPUT GAP IN JAPAN, 1991-2010.

5. Does the ratio of the current account over GDP give a good indication of how globalized an economy is? Explain.
6. Suppose investment, government expenditure, and exports are all zero in an economy. Consumption is 50 euros, and imports are 50 euros. What is nominal GDP? Do you think this situation is sustainable for the economy over the long run?
7. Suppose a carpenter purchases wood for 50 euros from a forester. The carpenter makes a table, which he sells for 70 euros. What was the rise in a) nominal GDP and b) incomes as a result of these transactions? What is each person's contribution to GDP?
8. In your opinion, which of the following would be the main determinant of how many gold medals a country wins in the Olympic games: a) real GDP per capita; b) nominal GDP per capita; c) real GDP; d) nominal GDP; e) growth in the CPI?
9. Suppose there is a economy, where the current account, the output gap, and government expenditure are always zero. In addition, potential GDP is the same over time. If consumption rises in this economy, what happens to investment? Would the answer be the same in potential GDP rises over time?