MGE-2
Homework Questions

1. What is the difference among the GDP Price Index, Consumer Price Index, and Producer Price Index?

2. The following data are for Argentina from 1985 to 2005.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Price Deflator</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>0.003</td>
</tr>
<tr>
<td>1986</td>
<td>0.005</td>
</tr>
<tr>
<td>1991</td>
<td>86.129</td>
</tr>
<tr>
<td>2000</td>
<td>100.000</td>
</tr>
<tr>
<td>2005</td>
<td>169.609</td>
</tr>
</tbody>
</table>


3. In 2006, many analysts argued that the Bank of Japan (BOJ) should pursue an inflation-targeting strategy. Suppose BOJ agreed and targeted an inflation rate of 0.5%. Explain the causes of an upward bias in the consumer price index and the implications for BOJ’s 0.5% inflation-targeting strategy.

4. If the real GDP were $400 and the price index were 0.9, what would nominal GDP be?

5. “If Japanese prices decreased each year from 1990 to 2005, and 2000 was the base year, then Japan’s nominal GDP should have been less than real GDP in each year.” Is this statement true or false? Explain.

6. What is a business cycle? How are business cycles measured? Identify three variables that vary procyclically and countercyclically.

7. If the real interest rate were 3%, the past year’s inflation rate were 30%, and the expected inflation rate for the coming year were 40%, then use the approximation formula to determine the nominal rate of interest. What would the nominal interest rate equal using the more precise formula?

8. In many nations, nominal interest rates fall when the central bank reduces the money supply (or when it reduces the money supply growth rate). Explain why.

9. In February 2001, about three months after its previous financial crisis, Turkey was hit by economic problems that endangered the nation’s chances of joining the European Union. Some business analysts suggested that Turkey should reduce inflation drastically because nominal interest rates would fall with lower expected inflation and thereby stimulate economic activity. Do you agree with this opinion?

10. Suppose that based on what you believe the inflation rate will be during the coming year, you estimate that the current real interest rate equals –15%. What should you do to profit from this information? How much do you expect to gain? Are you arbitraging (i.e., earning a risk-free return) or speculating? If you are speculating, what might cause you to lose on your bet?

11. Explain how inflation affects debtors and creditors.

12. Explain how inflation affects governments and taxpayers.

13. Explain whether inflation hurts the nation as a whole.

14. Explain the costs and benefits of indexation.
15. Which of the following economic variables are stock variables and which are flow variables? GDP, GNP, saving, savings, wealth, investment, capital, money supply, exports, imports, government spending, consumption, income, earnings, assets, and liabilities