

## Midterm Examination

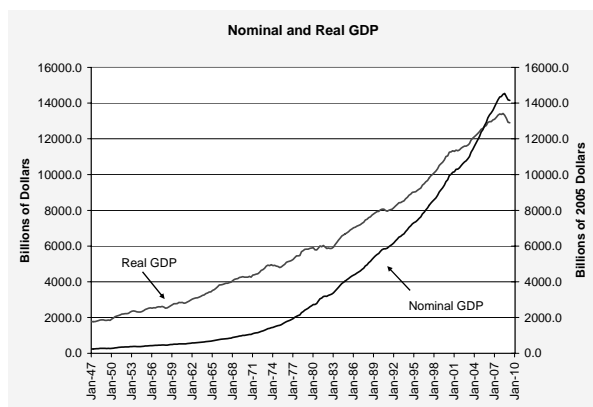
The exam is Tuesday, November 3 in class.  
It comprises 30-35 multiple choice questions.  
It covers material in lectures 10 and 12-18.  
The exam is "closed books and notes" and the honor code will be strictly enforced.  
Please bring a Scantron sheet and your UNC ID.  
Late comers will be barred.  
You may not leave the room during the exam.  
Practice questions and the key for back-of-chapter problems are posted on the web page.

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## Spending, Income and Gross Domestic Product

GDP is a Measure of a Nation's Output  
Several caveats about GDP  
The State of the US Economy  
What Have We Learned?

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## Gross Domestic Product: (GDP) is a Measure of a Nation's Output.

GDP measures how much an economy produces in a given period, such as a quarter or a year.

Because one cannot add "apples and oranges," GDP is constructed by adding together the market value of apples and oranges.

GDP avoids double counting by only counting the value of final goods and services.

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## Production in "Simple Land"

Year	Bread		Wine		Daycare		Nominal GDP	Real GDP
	Loaves	Price	Jugs	Price	Hours	Price		
2005	100	\$2.00	50	\$10	250	\$3.00		
2006	125	\$2.10	40	\$12	250	\$3.25		
2007	115	\$2.40	60	\$8	250	\$3.40		

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## GDP is Computed by Adding Together The Market Value of Final Products.

Year	Bread		Wine		Daycare		Nominal GDP	Real GDP
	Loaves	Price	Jugs	Price	Hours	Price		
2005	100	\$2.00	50	\$10	250	\$3.00	\$1450	
2006	125	\$2.10	40	\$12	250	\$3.25	\$1555	
2007	115	\$2.40	60	\$8	250	\$3.40	\$1606	

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## Nominal and Real GDP

Nominal GDP is measured in current dollars,  
Real GDP is measured in constant dollars.

Current year quantities are valued at base  
year prices.

Real GDP in the U.S. is currently measured  
in Year 2005 Dollars.

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## Real GDP is Computed by Using Base Year (2005) Prices to Value Current Year Production Quantities.

Year	Bread		Wine		Daycare		Nominal GDP	Real GDP
	Loaves	Price	Jugs	Price	Hours	Price		
2005	100	\$2.00	50	\$10	250	\$3.00	\$1450	\$1450
2006	125	\$2.10	40	\$12	250	\$3.25	\$1555	
2007	115	\$2.40	60	\$8	250	\$3.40	\$1606	

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Use Your Clickers to Answer  
The Following  
Graded Question.

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In 2007, Real GDP in Simple Land is

Year	Bread		Wine		Daycare		Nominal GDP	Real GDP
	Loaves	Price	Jugs	Price	Hours	Price		
2005	100	\$2.00	50	\$10	250	\$3.00		
2006	125	\$2.10	40	\$12	250	\$3.25		
2007	115	\$2.40	60	\$8	250	\$3.40		

- A. \$1450
- B. \$1490
- C. \$1580
- D. \$1606

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2007 Real GDP in Simple Land

Year	Bread		Wine		Daycare		Nominal GDP	Real GDP
	Loaves	Price	Jugs	Price	Hours	Price		
2005	100	\$2.00	50	\$10	250	\$3.00	\$1450	\$1450
2006	125	\$2.10	40	\$12	250	\$3.25	\$1555	\$1400
2007	115	\$2.40	60	\$8	250	\$3.40	\$1606	\$1580

Note:  $115 \times \$2.00 + 60 \times \$10 + 250 \times \$3.00 = \$1580$

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GDP can be divided into four  
expenditure components.

Consumption

Investment

Government Spending

Net Exports = Exports – Imports

$$GDP = C + I + G + NX$$

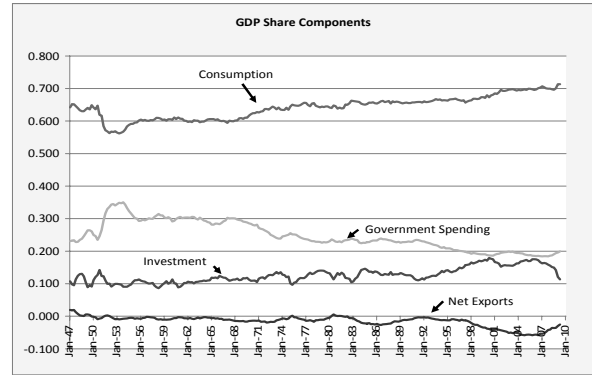
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## Expenditure Components of U.S. GDP, 2007 (billions of dollars)

<b>Consumption</b>		<b>9,732.0</b>
Durable goods	1,079.6	
Nondurable goods	2,833.0	
Services	5,819.4	
<b>Investment</b>		<b>2,132.3</b>
Business fixed investment	1,483.2	
Residential investment	641.5	
Inventory investment	7.6	
<b>Government purchases</b>		<b>2,691.4</b>
<b>Net exports</b>		<b>-712.7</b>
Exports	1,640.3	
Imports	2,353.0	
<b>Total: Gross domestic product</b>		<b>13,843.0</b>

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## How GDP Shares Have Varied

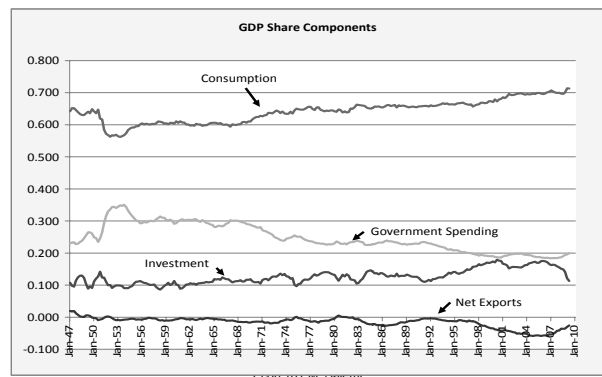


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Use Your Clickers to Answer  
The Following  
Graded Question.

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## What Themes Do You See in the Data?



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Which of the following is a correct statement about an expenditure component of GDP? Since 1947 ...

- A. The share of GDP used up by the government sector has risen steadily.
- B. Consumption has risen from 60 to 70 percent of GDP.
- C. Capital building has accounted for about one quarter of GDP.
- D. US exports have consistently exceeded US imports.

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## Take Care When Drawing Inferences with GDP Data.

GDP is not the same thing as satisfaction, welfare, or utility. A nation that maximizes its GDP does not necessarily maximize the welfare of its people.

GDP fails to account for valuable goods and services that are not traded in markets.

Growth in GDP does not automatically imply growth in goods available to all segments of the population.

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## More Caveats About GDP

Investment means the addition of productive capital.

Increases in the number or price of stock shares are not investment in the economic sense because they do not add physical capital to the nation's stock of capital.

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Use Your Clickers to Answer  
The Following  
Non-Graded Question.

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Which of the following transactions results in a change in GDP?

- A. The purchase of a 1990 Ford Bronco.
- B. The purchase of a share of IBM stock.
- C. The purchase of steel by General Motors.
- D. The payment of \$25 for dry cleaning.
- E. The payment of \$25 to your neighbor's kid for mowing your lawn.

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## The State of the US Economy

How did we get where we are now?

What is our current condition?

What are the prospects for the near future?

## How Did We Get Here?

By late 2007, a recession was a high probability event.

The proximate cause of the recession was the bursting of the housing bubble.

The potential collapse of financial institutions threatened by the sub-prime mortgage crisis made the stakes high.

## A Recession Was Likely

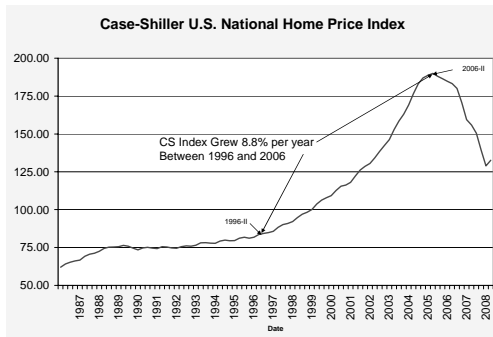
The recession began in December, 2007.

It is our 11<sup>th</sup> recession since WWII.

The preceding expansion began in November 2001 and lasted 73 months, 16 months longer than the post-WWII average.

A recession was due.

## The Bursting Bubble was the Proximate Cause of the Recession



## The Sub-Prime Crisis Threatened to Turn the Recession into a Depression

A sub-prime mortgage is a mortgage by a borrower with a low credit score, limited credit history or some other credit impairment.

A Collateralized Debt Obligation (CDO) is a derivative security that is issued against a portfolio of mortgages.

As home prices fell, so did the value of sub-prime mortgages and mortgage-backed CDOs.

The crisis spread to other financial institutions because potential lenders believed (rationally) that all financial institutions were vulnerable.

## Where Are We Now?

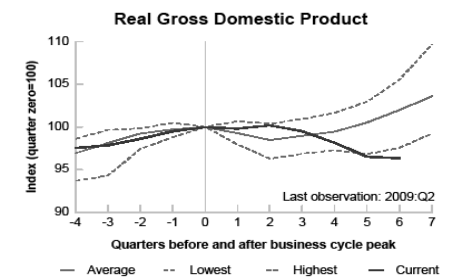
The current recession is unusually long and severe.

The average post-WWII recession lasted 10 months--the current recession has lasted 22 months.

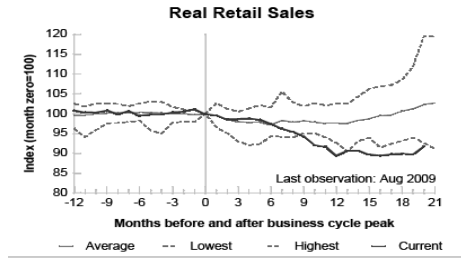
Leading indicators suggest that the recession is nearly over.

Unemployment will not abate for months.

## The Recession is Severe

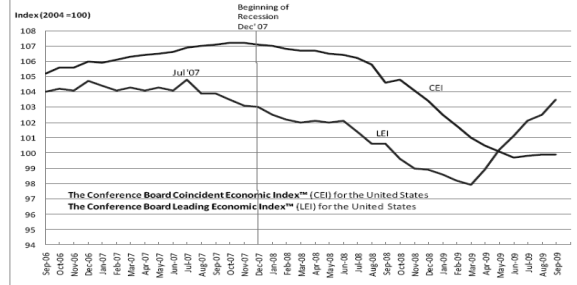


## The Recession is Severe



## The Recession Is Nearly Over

The Conference Board Leading Economic Index™ for the U.S. Improves; Sixth Consecutive Increase



## Tomorrow's News

The New York Times

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PRINTER-FRIENDLY FORMAT



October 30, 2009

### U.S. Economy Started to Grow Again in the Third Quarter

By CATHERINE RAMPPELL

Ending a year of contraction, the United States economy grew in the third quarter, the Commerce Department said on Thursday. But even if a recovery is technically in the offing, job seekers likely will not begin to feel the benefits for months to come.

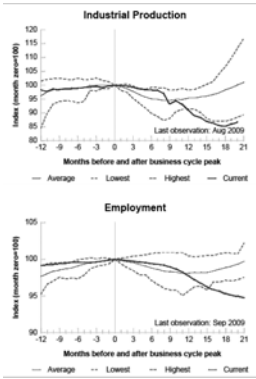
The nation's gross domestic product expanded at an annual rate of 3.5 percent in the three months ending in September, a significant spike from a somewhat shrunken base. The economy had contracted at annual rates of 0.7 percent and 6.4 percent in the second and first quarters of this year, respectively.

## Unemployment Will Not Abate for Months

Employment and unemployment lag production.

The unemployment rate peaked 15 months after the trough in the 1990-91 recession and 19 months after the trough in the 2001 recession.

## Unemployment Will Not Abate For Months



## Our Unfinished Economic Business

The Executive Branch Must continue to monitor the economy and apply stimulus as needed.

The Federal Reserve must decide when to begin unwinding the extraordinary expansion of credit that it has undertaken.

Congress, the Fed and the Executive Branch must decide on the right amount and kind of reform to regulation of financial institutions. It is important that this reform not go too far.

Congress and the Executive Branch must, going forward, address our twin deficit problem—fiscal deficits and current account deficits threaten our future.

## Where Do We Go From Here?

October 3, 2009

### Retailers Expect Flat Christmas Sales This Year

By STEPHANIE ROSENBLUM

In the retail business, it is never too early to think about Christmas. So a lot of people are thinking about it, and taking surveys to test the mood of the American consumer, and deciding that this Christmas will be as bad as last – which is to say, one of the worst on record.

Retailers are relieved to hear that prediction. Flat sales this holiday season would at least mean that things had stopped getting worse.

"It's reflective of this 'new normal' we're in," said James Russo, vice president for global consumer insights at the Nielsen Company. "Flat is good."

## What Have We Learned?

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## Measuring Macroeconomic Activity

Midterm Exam on Tuesday

Your recitation assignment for week 11 is posted on the web page.

GDP is a Measure of a Nation's Output.

Nominal GDP is measured in current dollars.

Real GDP is measured in constant dollars.

GDP comprises four expenditure components.

Be careful about inferences you draw using GDP.

It appears as if the recession is nearing an end...but employment will recover slowly.

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