Name:

Fall 2017

Principles of Macroeconomics

Week 5

1. What is inflation? Why are we concerned about inflation?

2. What is the measure of inflation that the US uses and who calculates this? How is it calculated?

3. In one or two sentences describe the basket of goods. How is this basket different from the basket of goods used to calculate the GDP deflator?

4. Is inflation always a bad thing? Can inflation be negative? What are the issues if it is?

5. A big concern with inflation arises from whether it is anticipated or unanticipated. Give an example for each.

6. Calculate the inflation rate for the years 2013, 2014 and 2015 by first filling in the table and then using the inflation formula. Your simple basket is composed of food, clothing and housing.

Component of Basket	**Weight of component**	**Price in 2012**	**Price in 2013**	**Price in 2014**	**Price in 2015**
Food	0.45	120	100	120	140
Clothing	0.25	210	240	235	245
Housing	0.3	600	610	640	650
Price of Basket					

7. For the following scenarios, I would like you to think of whether inflation is hurting or helping the economic agents involved. Also think about whether the inflation was anticipated or unanticipated.

   a) A rise in inflation driven by the sudden rise in gasoline prices in 2005 on an average American household.

   b) A jump in the price of housing (rentals) due to removal of rent control regulations leading to high rates of inflation.

   c) A homeowner who bought his house on mortgage at a very low interest rate.

   d) Think again of the sudden rise in oil prices and high inflation in 2005. What would happen to an average Saudi household knowing that their whole economy is dependent on oil.

   e) Your savings account with your local bank where you are earning a 2% return when the inflation suddenly jumps to 12%.