These prices are then used to construct the Consumer Price Index. CPI is an index. It is set equal to 100 in the period chosen as the base period and so its level has no particular significance.

- CPI is published monthly but GDP and the GDP deflator are only constructed and published quarterly.
- GDP deflator is the price of goods produced, whereas the CPI is the price of goods consumed.
- **Pure inflation** - a faster but proportional increase in all prices and wages.
- **Real wage -** the wage measured in terms of goods rather than in dollars.
- Why do economists care about inflation? Precisely because there is no such thing as pure inflation:
    - During periods of inflation, not all prices and wages rise proportionately. Because they don't, inflation affects income distribution. For example, retirees in many countries receive payments that do not keep up with the price level, so they lose in relation to other groups when inflation is high.
    - Inflation leads to other distortions. Variations in relative prices also lead to more uncertainty, making it harder for firms to make decisions about the future, such as investment decisions. Some prices, which are fixed by law or by regulation, lag behind the others, leading to changes in relative prices. Taxation interacts with inflation to create more distortions. If tax brackets are not adjusted for inflation, for example, people move into higher and higher tax brackets as their nominal income increases, even if their real income remains the same.
- Is deflation good? No. (1) High deflation (a large negative rate of inflation) would create many of the same problems as high inflation, from distortions to increased uncertainty. (2) Even a low rate of deflation limits the ability of monetary policy to affect output.
- What is the "best" rate of inflation? A low and stable rate of inflation, somewhere between 1 and 4%.
- If output growth is high, unemployment will decrease - **Okun's law**
- **Okun's law** - Output growth that is higher than usual is associated with a reduction in the unemployment rate; output growth that is lower than usual is associated with an increase in the unemployment rate.
- **Okun's law** implies that, with strong enough growth, one can decrease the unemployment rate to low levels.
- **Phillips curve** - a relation between the change in the rate of inflation and the unemployment rate. When unemployment becomes very low, the economy is likely to overheat, and that this will lead to upward pressure on inflation. A low unemployment rate leads to an increase in the inflation rate, a high unemployment rate to a decrease in the inflation rate.
- Successful economy is an economy that combines high output growth, low unemployment, & low inflation.
- What determines the level of aggregate output in an economy?
    - Movements in output come from movements in the demand for goods.
    - What matters when it comes to aggregate output is the supply side—how much the economy can produce. How much can be produced depends on how advanced the technology of the country is, how much capital it is using, and the size and the skills of its labor force. These factors—not consumer confidence— are the fundamental determinants of a country's level of output.
    - The technological sophistication of a country depends on its ability to innovate and introduce new technologies. The size of its capital stock depends on how much people save. The skills of workers depend on the quality of the country's education system. Other factors are also important: If firms