

## Principles of Macroeconomics Notes

### January 16<sup>th</sup> Lecture: Chapter Eight – GDP Accounting

- Nominal GDP
- When did national accounting begin? It began right after the great depression started. Simon Kuznet's report to Congress in 1934. Prior we had no data collection for unemployment rates, inflation, etc.
  - In 1934 he made the first national income account and presented it to Congress. In 1971 he received the Nobel Prize in economics for his work. Now, adopted by almost all countries – system of national accounts (SNA68, SNA93).
- **A precise definition of GDP:** gross domestic product – a measure of the market value of all newly produced final goods and services in a country during some period of time.
  - All goods are measured in the same units (e.g. US dollar – measured in the dollar that is sold at the time). Things that don't have a market value are excluded, e.g. housework you do for yourself.
  - So last year's GDP only includes things that were produced within that year – “newly produced”. GDP does not look at the resale market, so no used goods are included like used textbooks.
  - Intermediate products are goods that a company might purchase to use in the production of another good. For GDP, we only look at final goods.
    - A good that is an input to the production of other goods or services such as a bicycle tire that is sold to a bicycle manufacturing company would not be included in GDP to avoid double-counting.
  - GDP counts goods that are produced within the borders of said country. Toyota manufacturing their cars here in the US still counts towards our GDP, even if the headquarters are located in another country. If US companies outsource their manufacturing, then our GDP decreases because the good is no longer produced within our territory.
    - Example: a mini cooper that is made and assembled in the UK, and then purchased by an American, is not part of US GDP; it is part of the UK's GDP.
    - Goods produced by foreigners within US borders are included in US GDP.
  - “Period of time”: for example, if GM produces a 2014 Corvette Stingray in December 2012 but the car is not sold until January 2013, then that Corvette will be included in the GDP of the period in which it was produced – 2012. GDP data is reported quarterly and annually.
  - GDP: multiply price times quantity for each good, ex. 10 million \$30,000 new cars + 20 million \$1000 computers = \$320 billion for GDP.
  - Stockbroker's commission counted in GDP because the commission is the product of a service. The actual purchase of a stock is not included, but the commission is included.
- GDP is not the wealth of a country. Wealth includes things like infrastructure, which is necessary for economic growth.
- **Three ways to measure GDP:** the spending or expenditure approach – measures the total amount spent on goods and services made in the United States.
  - The income or factor payments approach: measures the total income earned by all factors of production that produce goods and services in the United States.
    - Factors of production: land labor capital and entrepreneurship.
    - The total value added in the economy from the sale of one ream of paper is \$5, where does this money go? Look at PowerPoint slides.

## February 18<sup>th</sup> Lecture: Exchange Rate Systems

- A country has a **floating exchange rate or floating currency** when the government lets the market determine the exchange rate. Ex: Canadian dollar, US dollar, Japanese yen, and British pound.
  - There is no such thing as a pure floating currency, because most countries intervene in the market for their country. Canada for instance is one of the countries that interferes least with their currency market.
- Under a **managed float (or a dirty float)**, a country's central bank actively manages its exchange rate. For example: buying its own currency to prevent depreciations, or selling its own currency to prevent appreciations.
- A **fixed exchange rate or "pegged" exchange rate** is a government-declared exchange rate maintained by central bank intervention in the foreign exchange market. Worth is determined by:
  - A fixed weight of gold ex. Gold standard (1870s – 1930s in the US). You can only issue as much paper currency as you have gold. Ron Paul hahahahaha.
  - A fixed amount of another currency ex. The Bretton Woods system (1944 – 1970s) with the US\$ as the official reserve asset. Gold exchanged for \$35 per ounce by central banks.
  - A fixed amount of a basket of other currencies – Bahamian dollar, Lebanese pound, Saudi riyal, Hong Kong dollar, Chinese renminbi.
- A country will peg below the market rate to protect export-oriented industries. A country will peg above the market rate to protect import-oriented industries and consumers (want currency to be very high in value so that these imports cost less).
  - A country will peg if the exchange rate is too volatile and makes doing business and trading too risky.

## February 20<sup>th</sup> Lecture: Exchange Rate Systems

- **Devaluation** is a reduction in the value of a currency that previously had a fixed exchange rate. Example: Venezuelan Bolivar.
  - In 2003, currency fixed at 1600 bolivars per US dollar. Repegged at 1920 bolivars per US dollar in 2004 and 2150 bolivars in 2005. In 2008, lopped three 0's from currency and issued new notes and coins – bolivar fuerte.
  - Repegged in 2010 at 2.6 bolivars/\$ (\$0.39 per bolivar) (for goods being imported – necessities) and 4.3 bolivars/\$ (\$0.23 per bolivar) (for anyone who wanted to purchase foreign goods). Double exchange rate system.
- **Revaluation** is an increase in the value of a currency that previously had a fixed exchange rate.
  - 1995-2004, set at \$0.12 per Yuan (well below equilibrium). Beginning in 2005, the People's Bank of China has been revaluing the Yuan. It is now about \$0.16 per Yuan (still below equilibrium).
- Foreign investment in the US shows up as positive entry in the US financial account.
- The demand curve for dollars will shift to the right when speculators expect that the value of the dollar will rise relative to the value of the yen.
- What happens in the foreign exchange market affects the economy and what happens in the economy affects the foreign exchange market.
- **What are the determinants of exchange rates?**
  - The very short run (hot money): interest rates, investor's expectations about future value of currency (interest rates and expectations change both the supply curve and the demand curve).
  - Short run: Real GDP – all else equal, if real GDP rises the domestic currency will depreciate, if real GDP falls the domestic currency will appreciate.