Q3

Write in the box the number of the question you are answering on this page as it is designated in the exam.

(a) $GDP = P \times Q$

Nominal GDP $= 6 \times 1100 + 2 \times 1000 + 800 \times 2$

$= 2400 + 2000 + 1600 = \$6000$

(b)(i) Inflation rate $= \dfrac{(\text{GDP deflator this year}) - (\text{GDP deflator in base year})}{\text{GDP deflator in base year}} \times 100$

Inflation rate $= \dfrac{150 - 100}{100} \times 100 = \dfrac{50}{100} \times 100 = 50\%$

(ii) Real GDP $= \dfrac{\text{Nominal GDP}}{\text{GDP deflator}} = \dfrac{6000}{150} \times 100 = \$4000$

Real GDP $= \$4000$

(c) Their real wages have decreased. This is because as inflation is higher than nominal increase in wages, the real wages will buy comparatively less by: $\boxed{\text{Nominal} - \text{Inflation} = \text{Real}}$

(d) He or she would be better off. As GDP deflator increases, inflation will increase. When the borrower pays back his loan with the interest, in real value terms the borrower has paid less. This is because as inflation increases the real value of money will decrease, so now the lender cannot buy as many goods as he could before the unexpected increase in inflation.