**Topic 1D: CPI, Inflation, and REAL GDP**

**LVL 1: As you read, answer the following questions**

1. How is CPI calculated?
2. What is inflation?
3. What is deflation?
4. How is the rate of inflation calculated?
5. What do rising price levels typically say about the economy?
6. What is the difference between REAL GDP and NOMINAL GDP?
7. How is REAL GDP calculated?

**SSEMA1 Illustrate the means by which economic activity is measured.**

Economic activity derives from the sectors of the economy we explored in the fundamentals and microeconomics domains. Individuals, businesses, markets, and governments all interact to create a country’s economy. The degree of strength or weakness of all economic activity in an economy will affect the individual components of that economy. For this reason, public and private entities constantly measure specific types of economic activity and synthesize the data to create a picture of the economy’s health. The pictures drawn by the data inform policy makers who may choose to intervene in the economy to meet economic goals.

1. **Define Consumer Price Index (CPI), inflation, real GDP, and explain how each is used to evaluate the macroeconomic goals from SSEMA1a**

The **Consumer Price Index (CPI)** is also a statistic reported monthly by the BLS. The statistic measures the change in value of a basket of goods and services purchased by the average urban consumer. To calculate CPI, take the current value of the market basket, divide it by the value of the market basket in the base year, and multiply the quotient by 100 to get the index number. The base year is simply the year the BLS has chosen to be the year of comparison. As of the writing of this document, the BLS uses the value of the basket in 1982-1984. Statisticians use the resulting CPI number to calculate the inflation rate in the country.

**Inflation** is a sustained increase in the price level in an economy over time. One way to measure whether there is inflation in the economy is to calculate the inflation rate. The inflation rate is equal to the percent change in a price index number such as the CPI. Percent change in CPI is equal to the new CPI minus the old CPI divided by the old CPI times 100. If the result of this calculation is positive then the price level is rising. Most economists do not want the inflation rate to be zero percent and agree that some inflation will occur when an economy is growing. Increases in the price level become a concern when they happen too quickly, when they make it difficult for households and firms to plan for the future, when they occur because of shocks in markets for productive resources, or when they are a result of inappropriate public policy decisions.

**Real GDP** is the value of current gross domestic product adjusted for inflation. This is a more accurate view of a country’s productivity than just the current dollar value of the output expenditure model discussed in SSEMA1b. Before adjusting for inflation, an increase in GDP could be due to an increase in the prices of the final goods and service produced rather than an increase in the quantity of goods and services produced. To calculate real GDP, take the value of the output expenditure model from SSEMA1b, divide it by a price index number such as CPI, and multiply the quotient times 100. The result is GDP adjusted for changes in the price level. Most countries measure economic growth through calculating the percentage change in real GDP from one period to the next.

**LVL II Consider the following questions**

1. How is inflation typically measured?