

# **Mankiw Macro Chapter XI: The cost of Living**

## **Pg 217-230**

### **Measuring the cost of living**

The cost of food today, vs. the cost of rice 40 years ago  
The amount of MONEY to buy food has increased  
The Percent of income has gone down

So how to measure changes in prices?

### **The Consumer Price Index (CPI)**

Uses a basket of goods, and compares the price of that basket over time  
The basket is composed of typical goods used by consumers  
The goods are weighted by how much they are used  
You then find the price of the goods over multiple years  
You then choose a base year, and compare against it

### **Problems with this method**

Substitution bias  
The proportion of goods being used changes  
As relative prices change, the amount purchased changes  
Introduction of new goods  
Consumers start purchasing goods that didn't exist before  
Unmeasurable changes in quality  
How to account for better goods at the same price?

Example: Avatar or Gone with the Wind?

GDP Deflator (pg 224-225) Skip

### **Indexation**

When you take account of inflation over time  
For example, Social Security indexes for inflation  
So the payments go up each year, as inflation goes up

### **Real and Nominal Interest Rates**

**Nominal and Real Variables (recap)**

**Numeric example of real and nominal interest rates....**