The consumer price index for the 1978-82 periods and the GDP deflator follow. This was a period of unusually high, but declining, inflation. (The CPI is equal to 100 in the base years, 1982 - 84; the GDP deflator is equal to 100 in the base year 1987) CPI GDP Deflator 1978 65.2 60.3 1979 72.6 65.5 1980 82.4 71.7 1981 90.9 78.9 1982 96.5 83.8

A : Calculate the rate of inflation according to both measures from 1979 through 1982 .What might explain the differences between the two B:

Suppose that the hourly wage rate for a group of workers that sign an employment contract for the three year period starting in 1979 is indexed to the CPI according to the formula

ΔW/W= 0.03 +0.05 ΔCPI/CPI

Calculate the actual increase in wages during each year of the contract period. If the wage is $12.00 in 1979, what was it in 1980, 1981, and 1982? What happens to the real wage measured in terms of the CPI Repeat your calculations with 0.03 reduced to 0 and 0.5 increased to 1 .What indexing formula would the workers employer have preferred? Is there any reason for the employer to have been happy with the other formula before the actual inflation experience was known?

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