DOMESTIC AGGREGATE DEMAND AND INFLATION

Word Count: 2000 (+-10%)

## Introduction

Aggregate demand refers to the total quantity of goods and services that households, businesses, government entities, and foreign buyers are collectively willing and able to purchase at different price levels within an economy, typically over a specified period (Mankiw, 2020). Inflation, on the other hand, represents the sustained rise in the general price level of goods and services, which consequently diminishes the purchasing power of money (Blanchard, 2021). Economic theory has long highlighted a crucial interrelationship between aggregate demand and inflation, primarily through the concept of demand-pull inflation. According to Keynesian perspectives, an increase in aggregate demand, especially when an economy is near or at full employment, tends to create upward pressures on prices, thus leading directly to inflationary outcomes (Krugman, Obstfeld, & Melitz, 2022). This linkage underscores the importance of managing aggregate demand effectively to stabilize prices.

Within the Nigerian context, this relationship between aggregate demand and inflation presents significant implications for macroeconomic stability and policy formulation. Nigeria's economic landscape frequently experiences fluctuations driven by fiscal expansions, monetary policy adjustments, and volatile external conditions, notably in oil markets, which significantly impact aggregate demand dynamics and consequently influence inflation (Central Bank of Nigeria [CBN], 2022). The objective of this essay is thus to critically examine the theoretical foundations and practical manifestations of this interaction, highlighting empirical examples specific to Nigeria, evaluating policy interventions, and proposing pragmatic policy adjustments. The subsequent sections will systematically explore these dimensions, first establishing the theoretical underpinnings, followed by a robust empirical analysis, and concluding with strategic recommendations aimed at effective demand and inflation management in Nigeria’s economic framework.