



LECTURE TWO - PART FIVE



Why The AD Curve Can Shift

- We now understand why the AD curve slopes downward.
- Let's also understand why the AD can shift!
- Remember: the AD graph shows the various amounts of real output that would be purchased at each possible price level, holding other things constant.
- By understanding what these “other things” are, we can understand why the AD curve shifts!

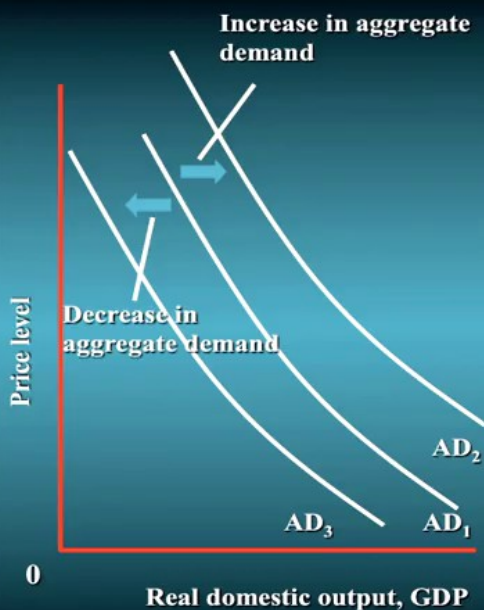
Factors shifting the AD curve

1. Change in consumption spending
 - a. Consumer wealth
 - b. Consumer expectations
 - c. Household indebtedness or credit conditions
 - d. Tax policy
2. Change in investment spending
 - a. Interest rates
 - b. Profit expectations on investment projects
 - c. Business taxes
 - d. Technology
 - e. Degree of excess capacity
3. Change in government spending
4. Change in net export spending
 - a. National income abroad
 - b. Exchange rates

♦ These factors are referred to as the determinants of aggregate demand because they determine the location of the aggregate demand curve.

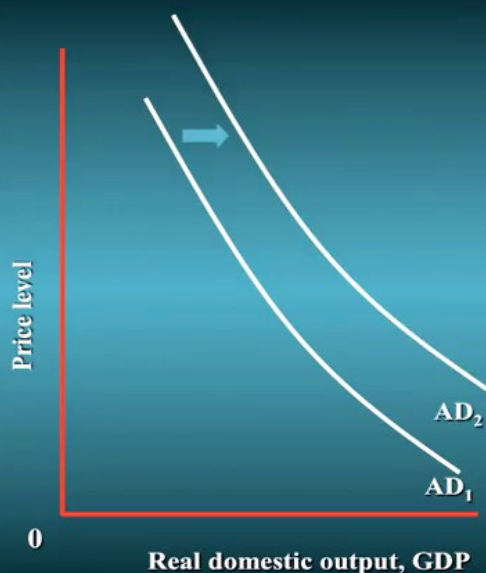
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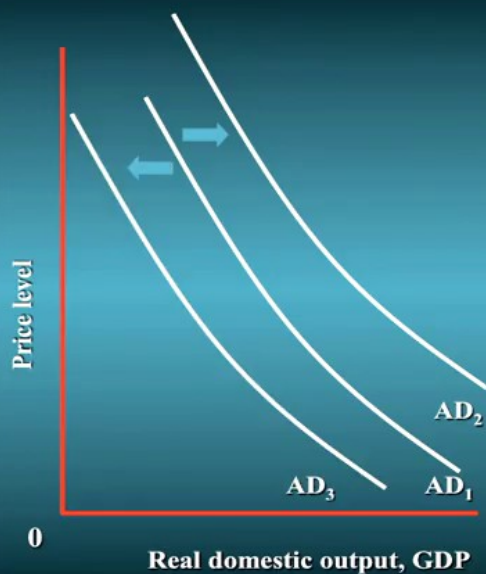
Factors shifting the AD curve

1. Change in consumer spending
 - a. Consumer wealth ↑
 - b. Consumer expectations ↑
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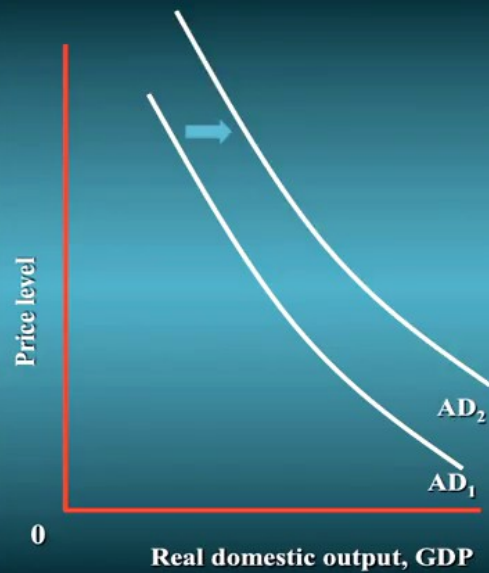
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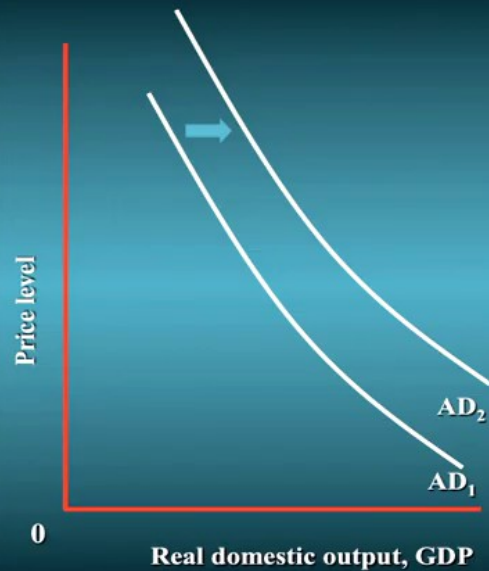
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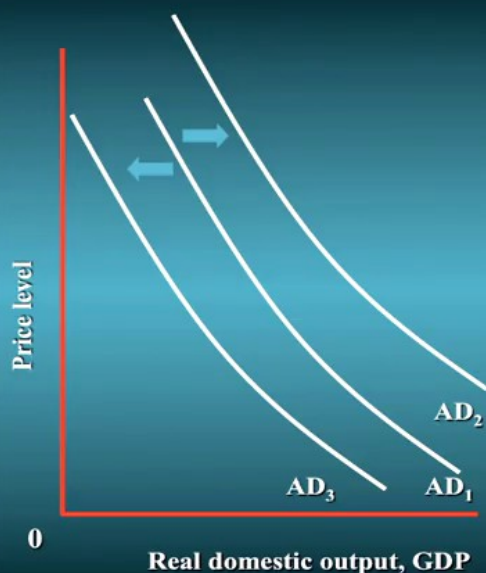
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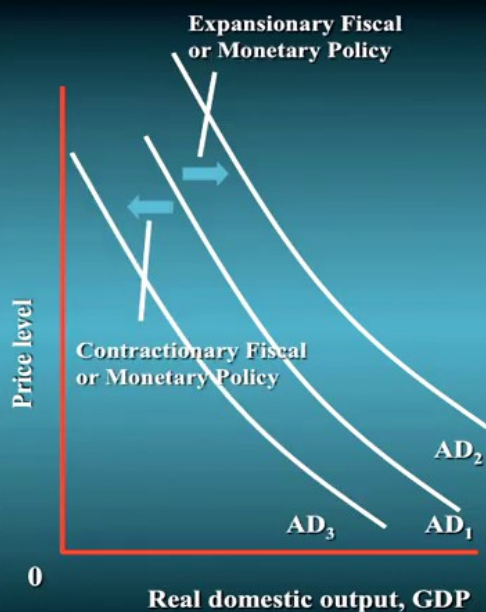
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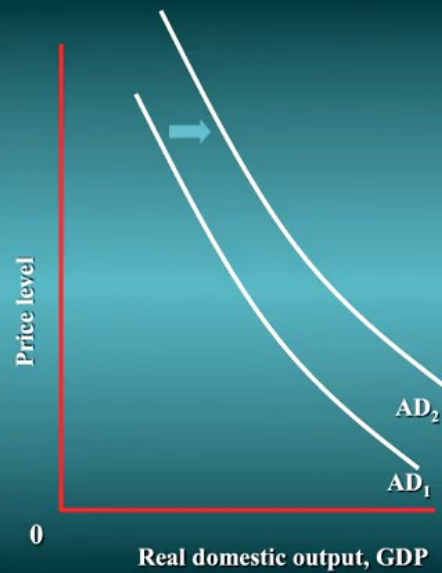
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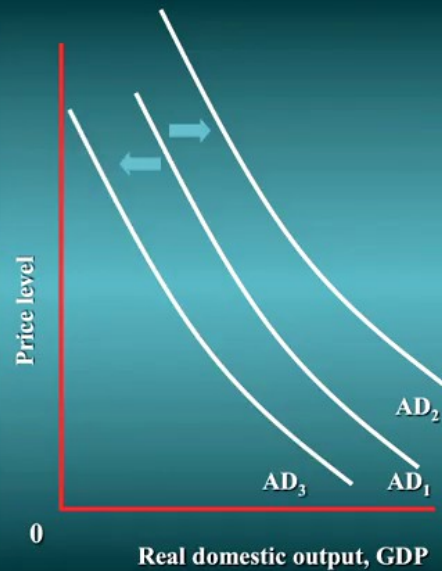
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 - a. National income abroad ↑
 - b. Exchange rates ↑ (strengthens)

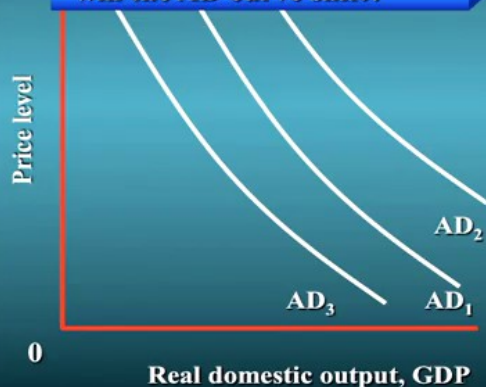


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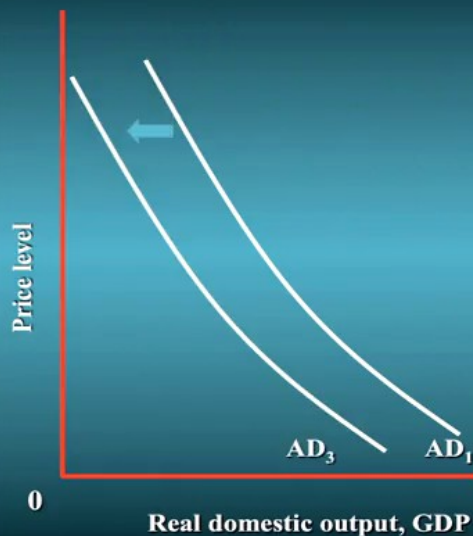
✦ Suppose that the Dow Jones stock market average plunges 2000 points in a week.

✦ Which item in the table will this affect and which way will the AD curve shift?



Factors shifting the AD curve

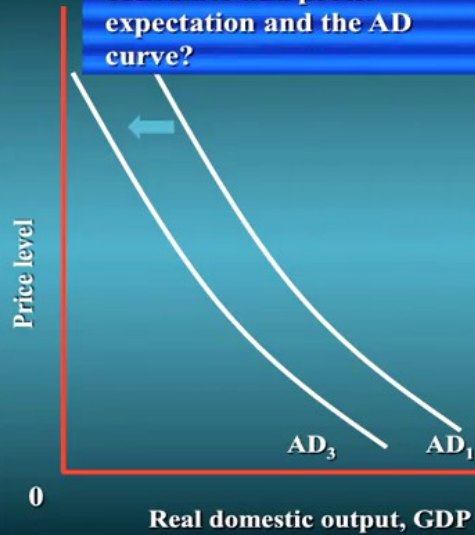
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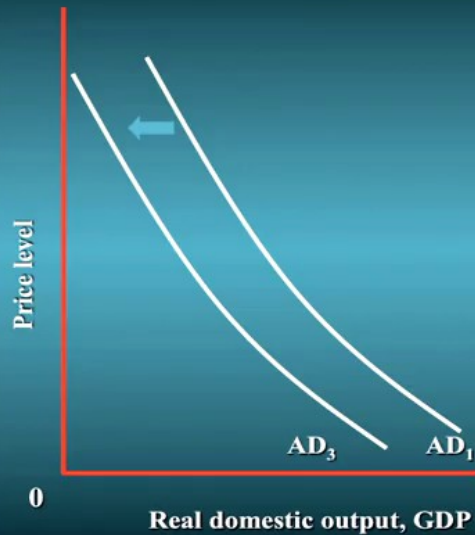
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♦How might news of a possible recession affect consumer and profit expectation and the AD curve?

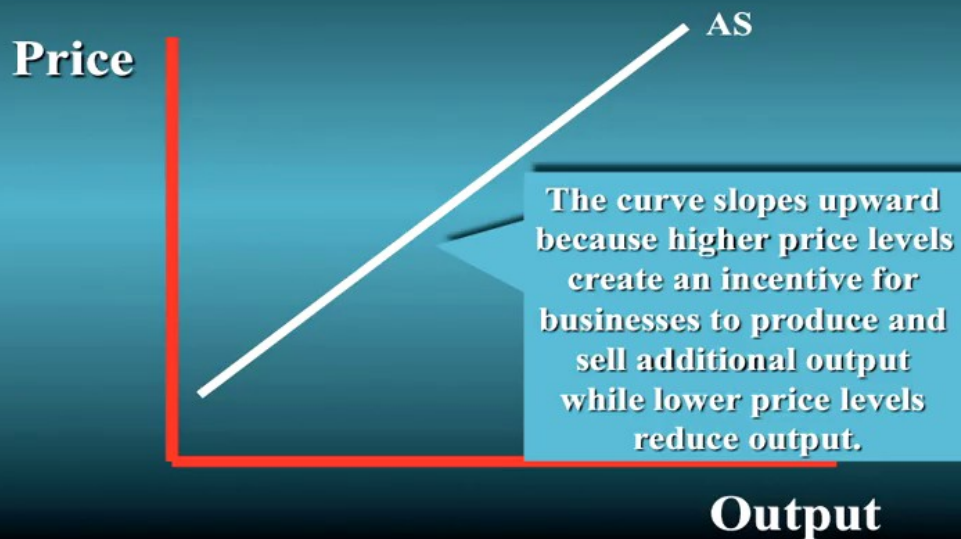


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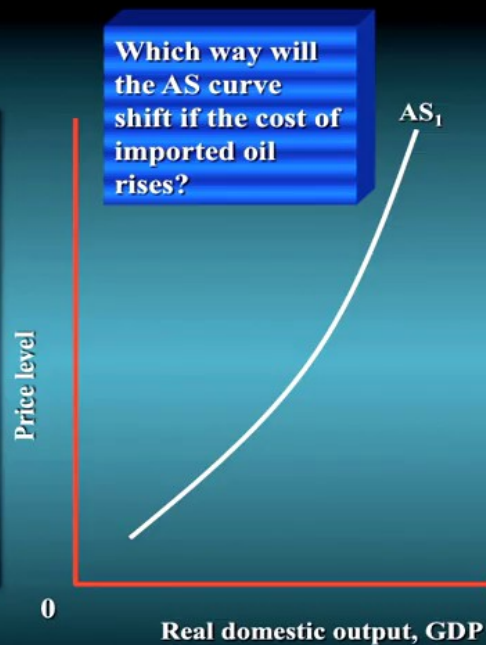


The AS-AD Framework



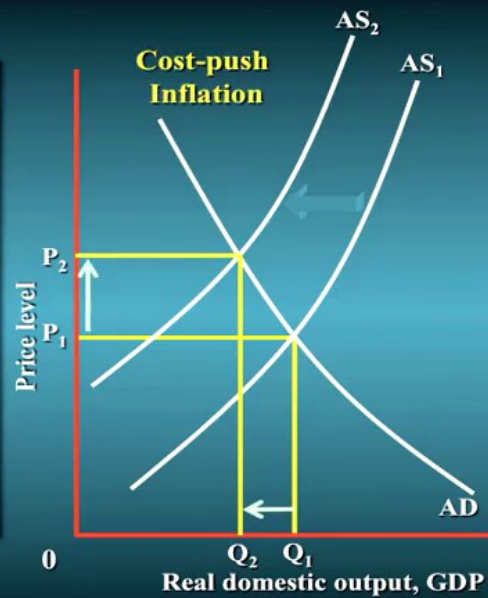
Factors shifting the AS curve

1. Change in input prices
 - a. Domestic resource availability
 - a. Land
 - b. Labor
 - c. Capital
 - d. Entrepreneurial ability
 - b. Prices of imported resources
 - c. Market power
2. Change in technology and productivity
3. Change in legal-institutional environment
 - a. Business taxes and subsidies
 - b. Government regulations



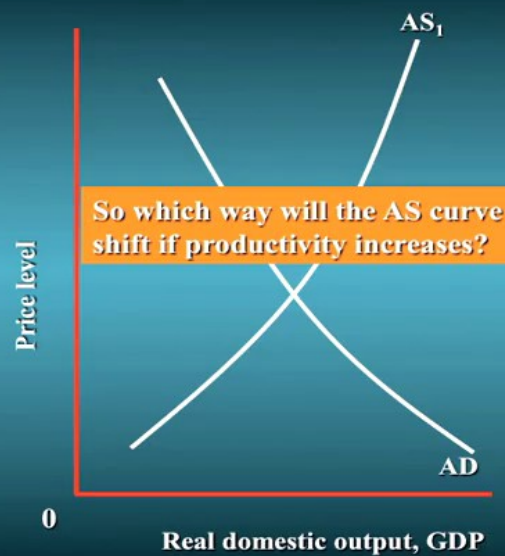
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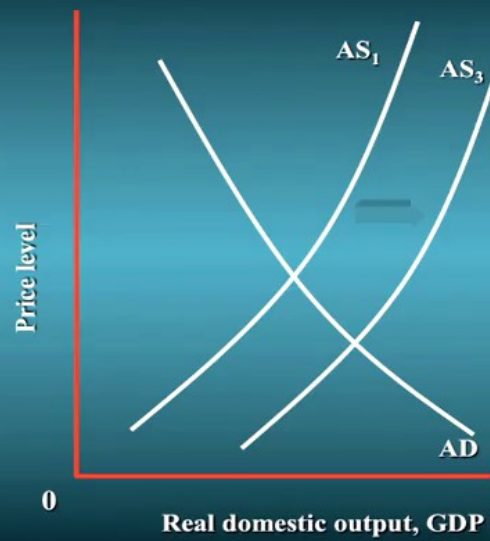


$$\text{Productivity} = \frac{\text{total output}}{\text{total inputs}}$$

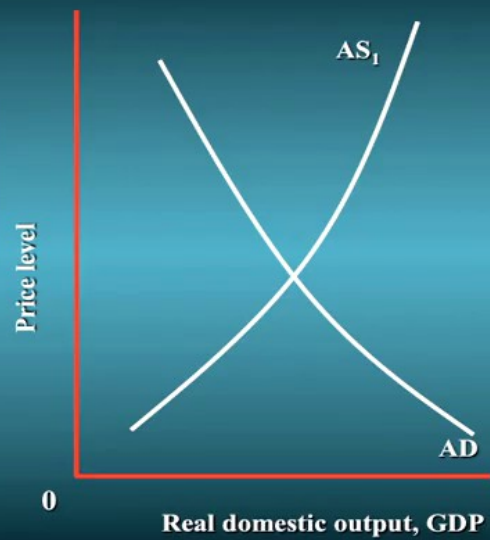
♦ An increase in productivity means the economy can obtain more real output from its limited resources.



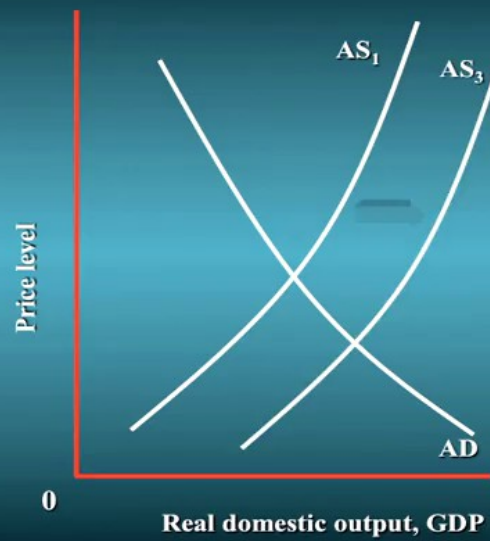
♦ Increases in productivity increase the potential output of an economy.



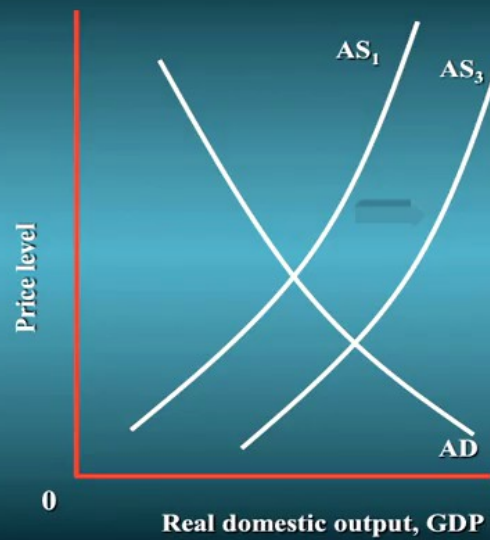
♦ What will happen to the AS curve if the sales tax or the payroll tax or excise taxes are decreased?

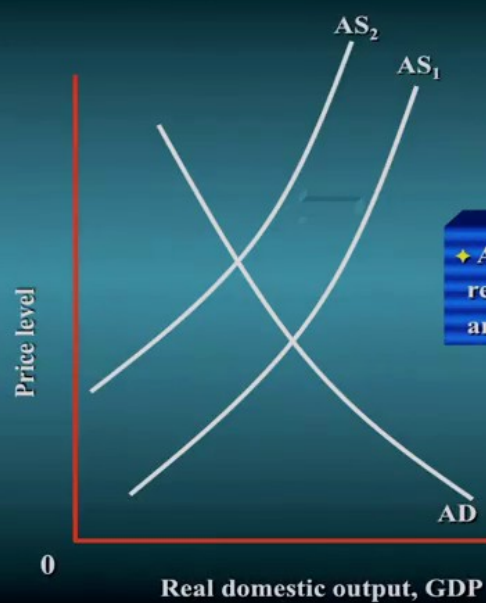


♦ A tax decrease will decrease production costs and thereby increase aggregate supply.



♦ What about an increase in government regulation such as tougher clean air or clean water requirements?





✦ An increase in government regulations increases costs and shifts the AD curve in.