Figure 14.1. Fluctuations in output and the size of government in the US (1870-2015).

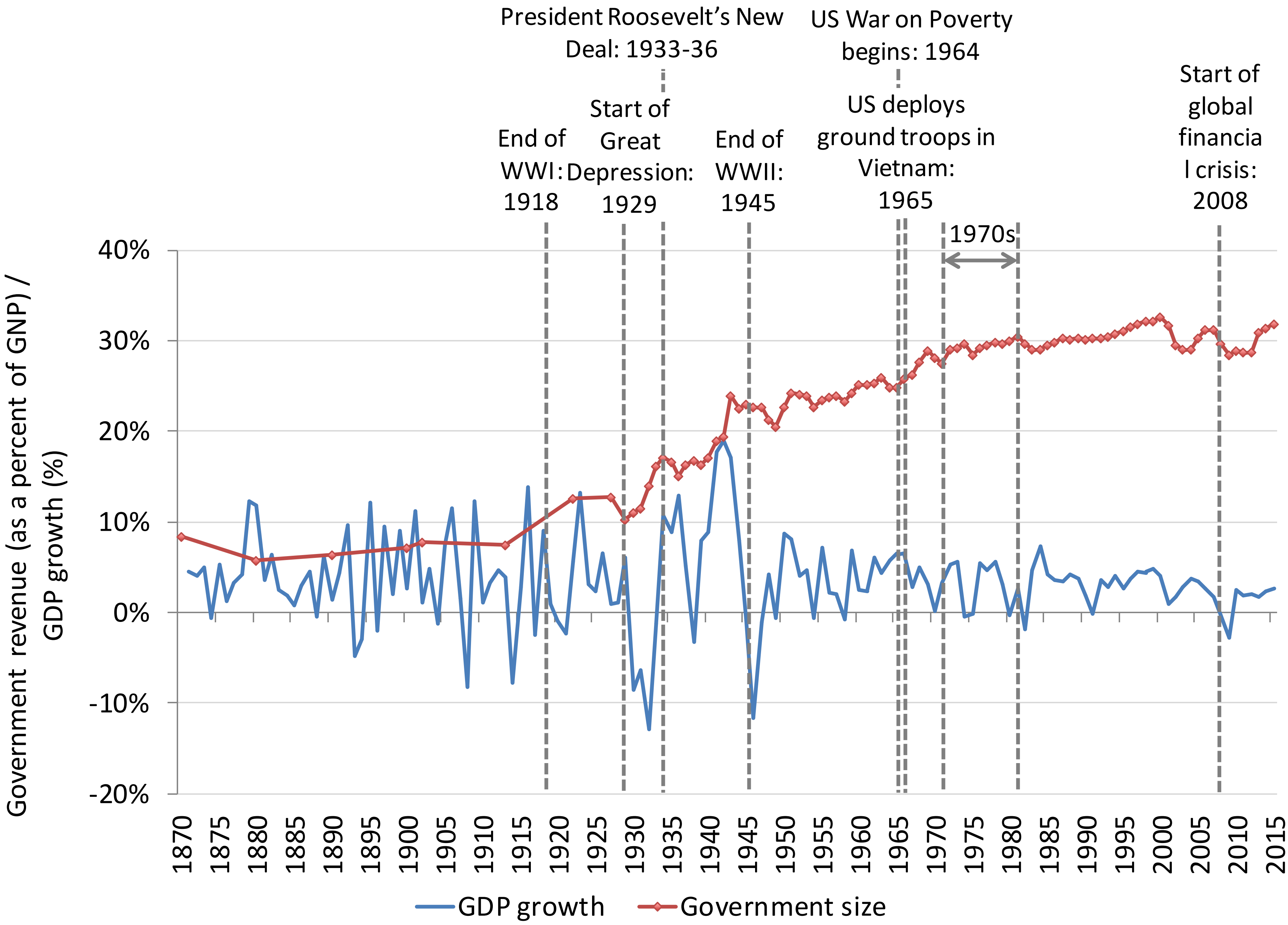


Figure 14.2. The aggregate consumption function.

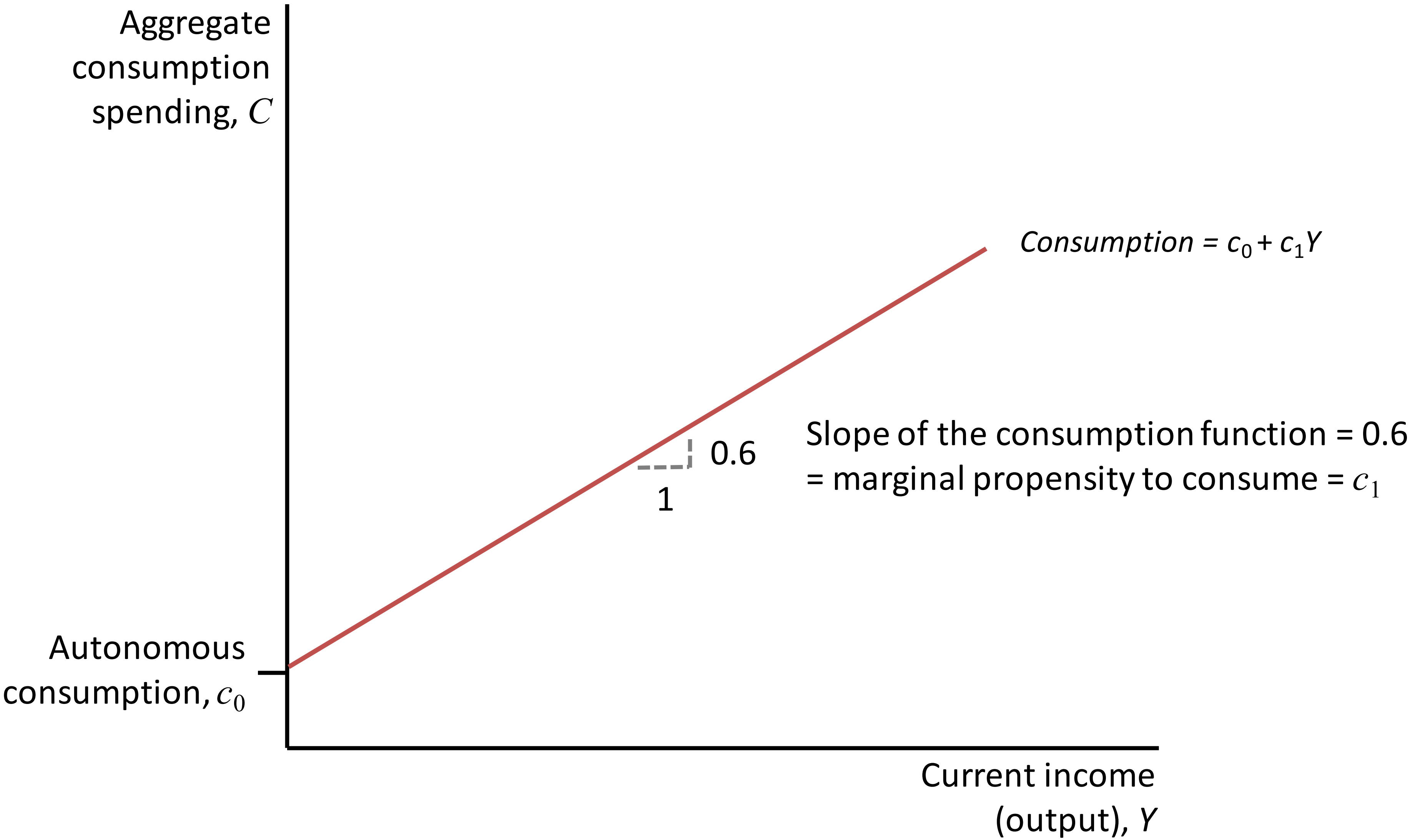


Figure 14.3. Fear and household consumption in the US during the global financial crisis (2008 Q1 – 2009 Q4).

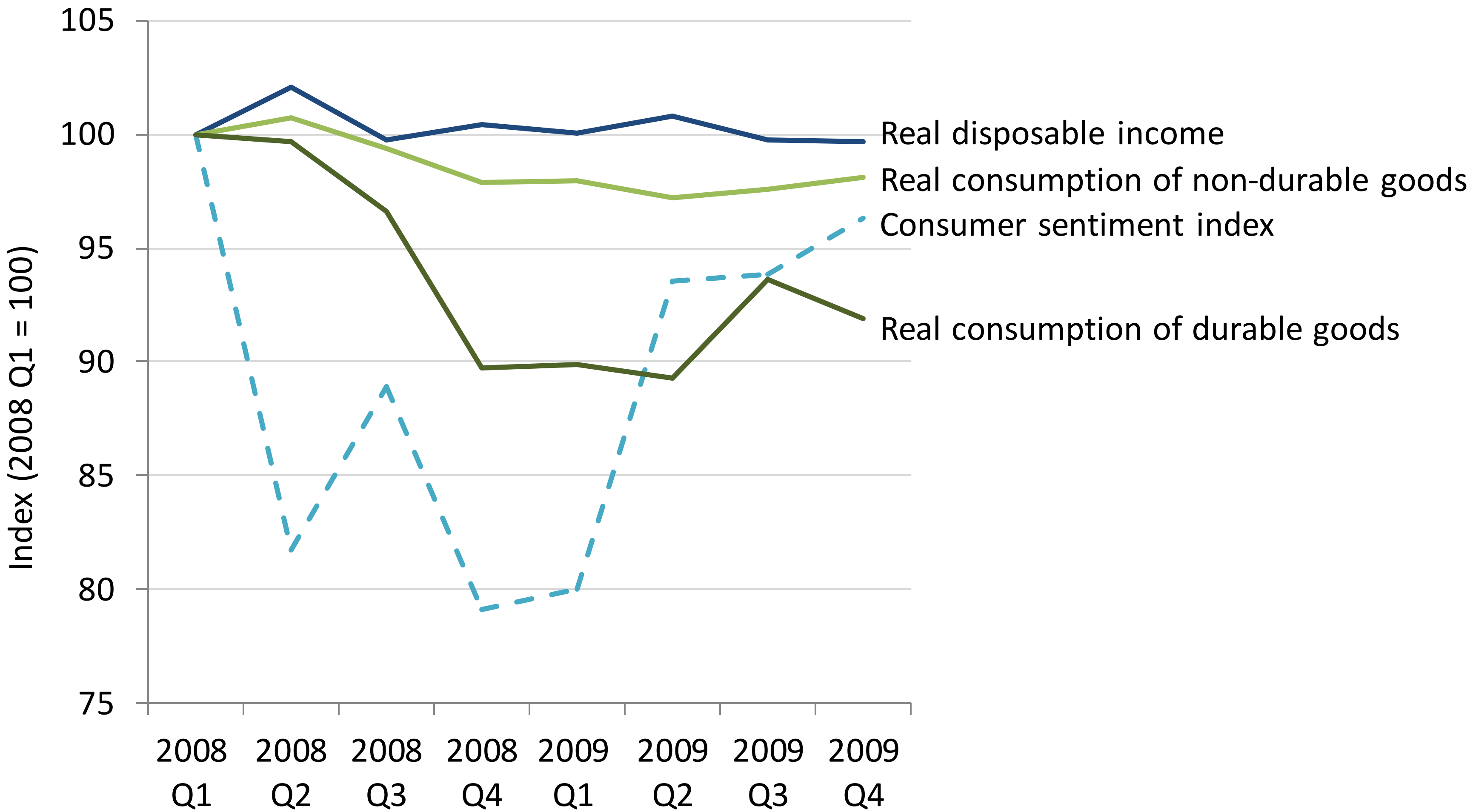


Figure 14.4. Goods market equilibrium: The multiplier diagram.

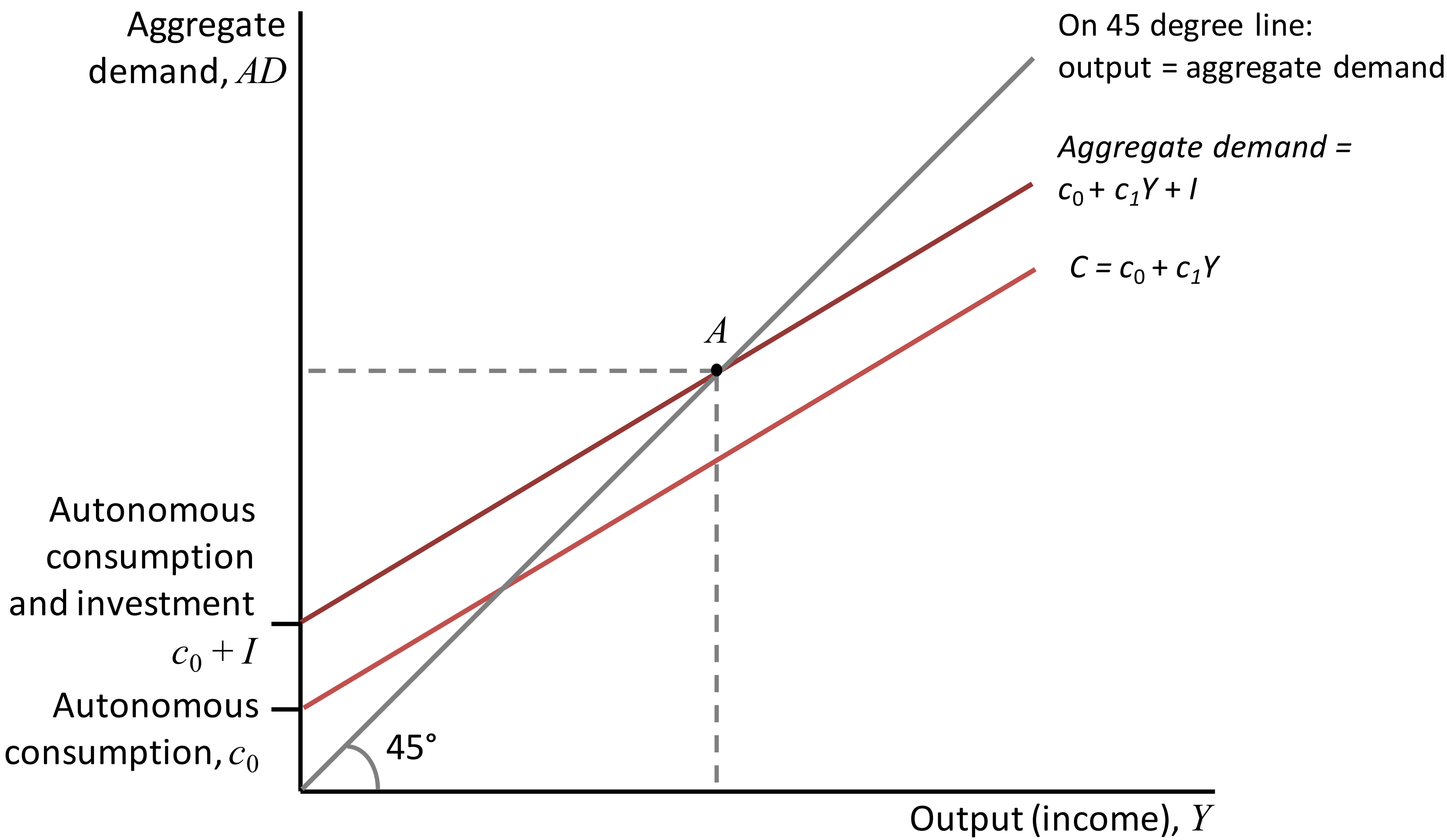


Figure 14.5. The multiplier in action: An investment-led recession.

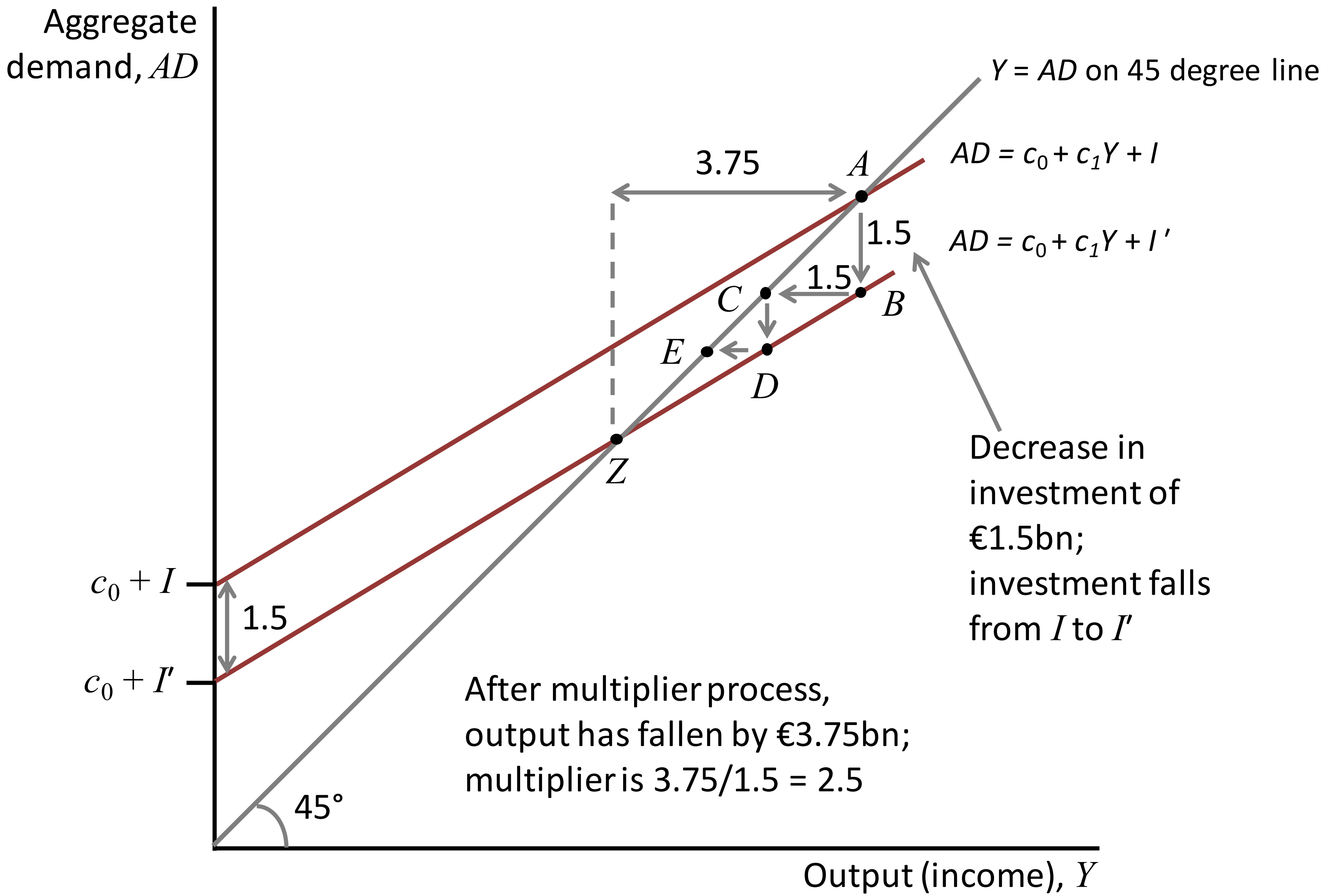


Figure MCQ2

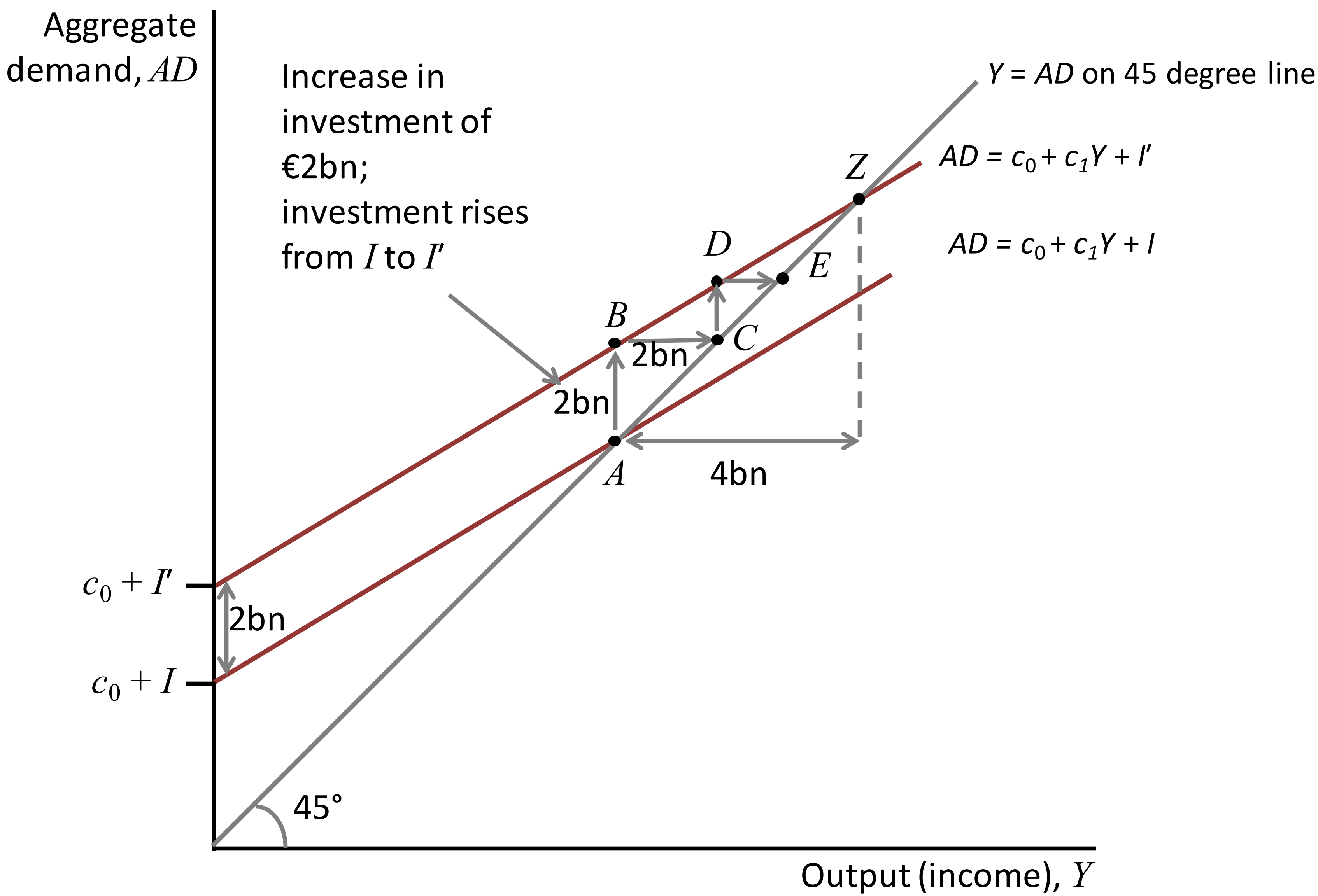

Aggregate demand, AD
Increase in investment of €2bn; investment rises from I to I′
Y = AD on 45 degree line
AD = c0 + c1Y + I′
AD = c0 + c1Y + I
Z
D
E
B
C
2bn
2bn
2bn
A
4bn
c0 + I′
c0 + I
45°
Output (income), Y

Figure 14.6. Aggregate demand in the Great Depression: Multiplier and positive feedback processes.

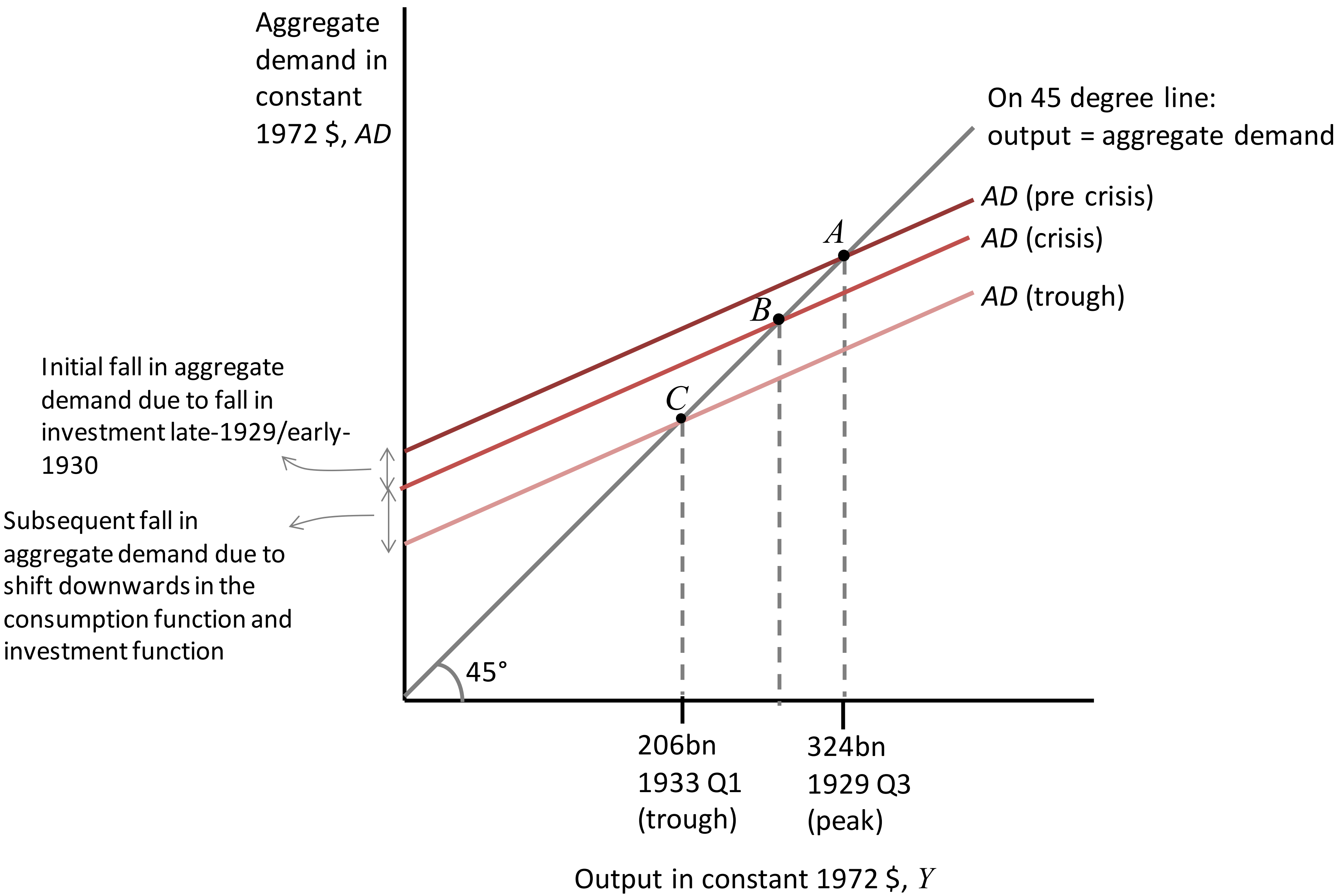


Figure 14.7. Household wealth: Key concepts.

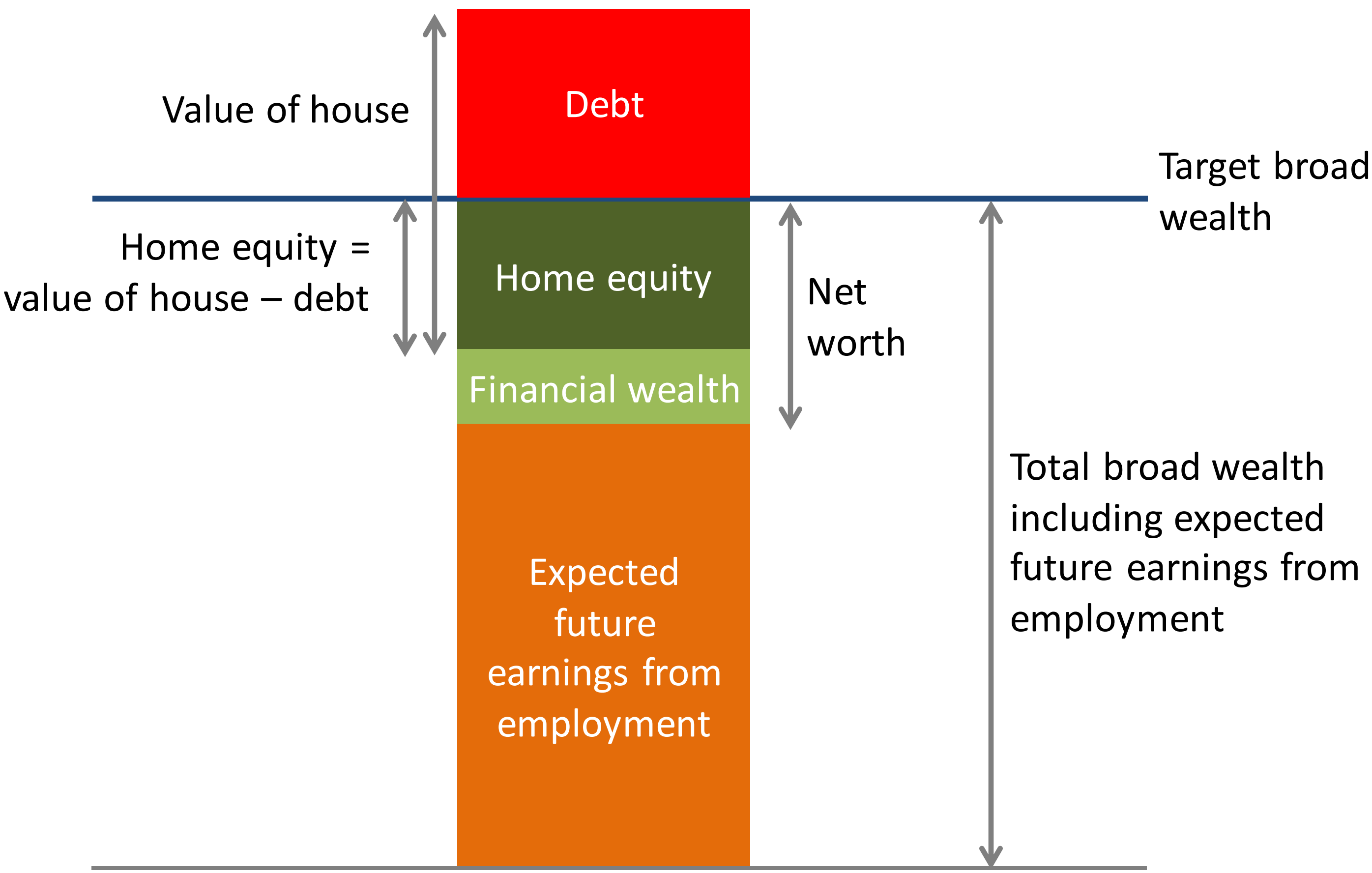


Figure 14.8. The Great Depression: Households cut consumption to restore their target broad wealth.

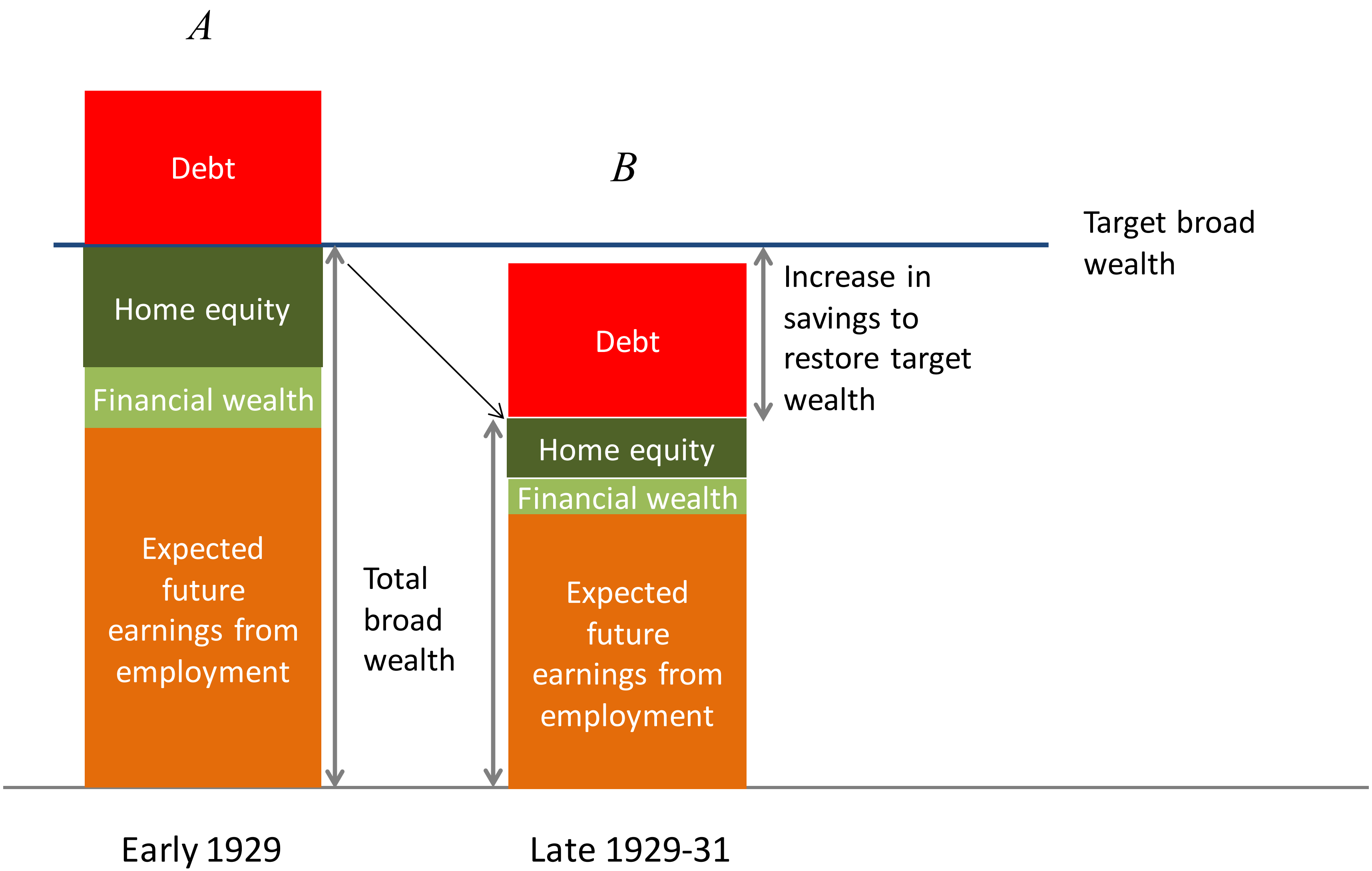


Figure 14.9. Investment, expected rate of profit, and the interest rate in an economy with two firms.

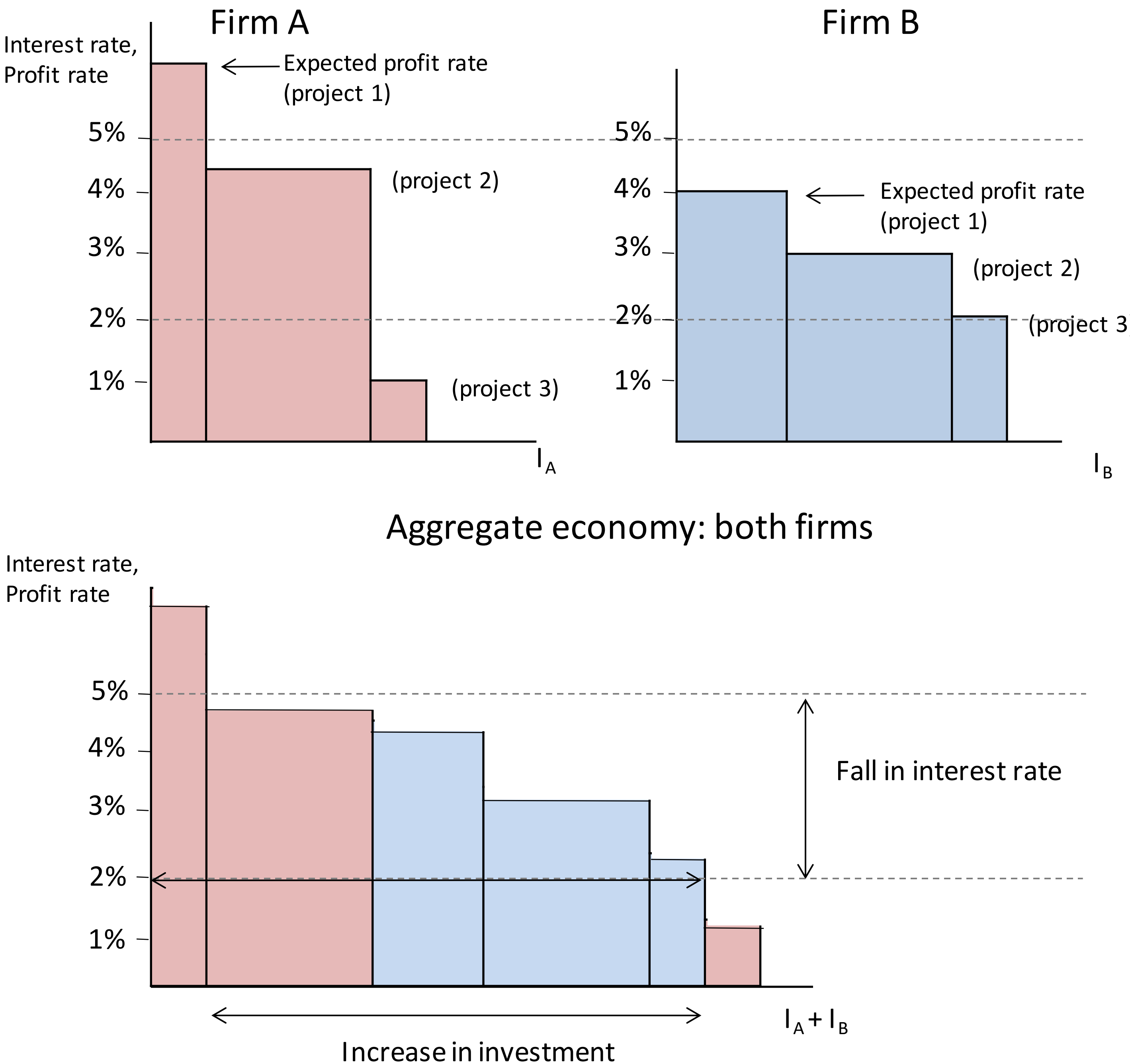


Figure 14.10a. The aggregate economy, where the expected rate of profit rises for a given set of projects (supply effect).

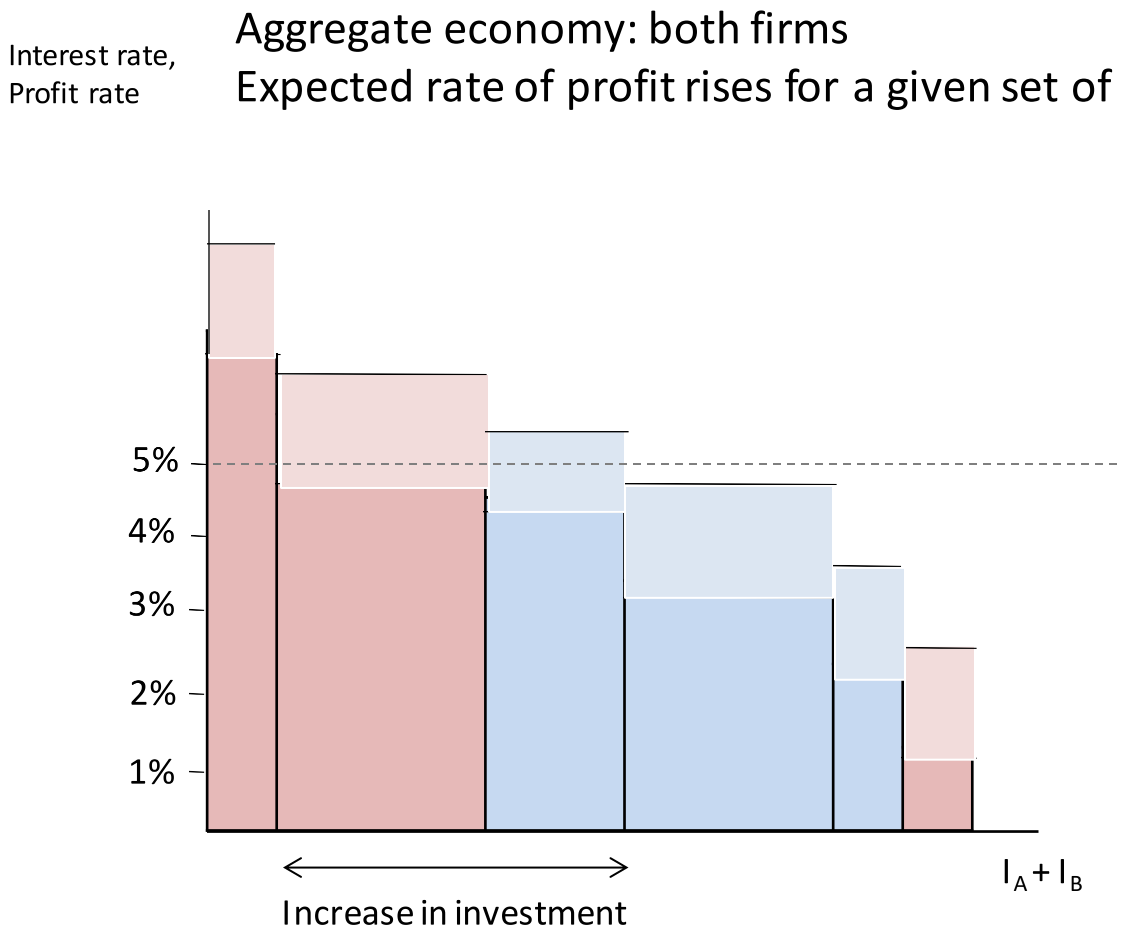


Figure 14.10b. The aggregate economy, where the desired capacity rises for each project (demand effect).

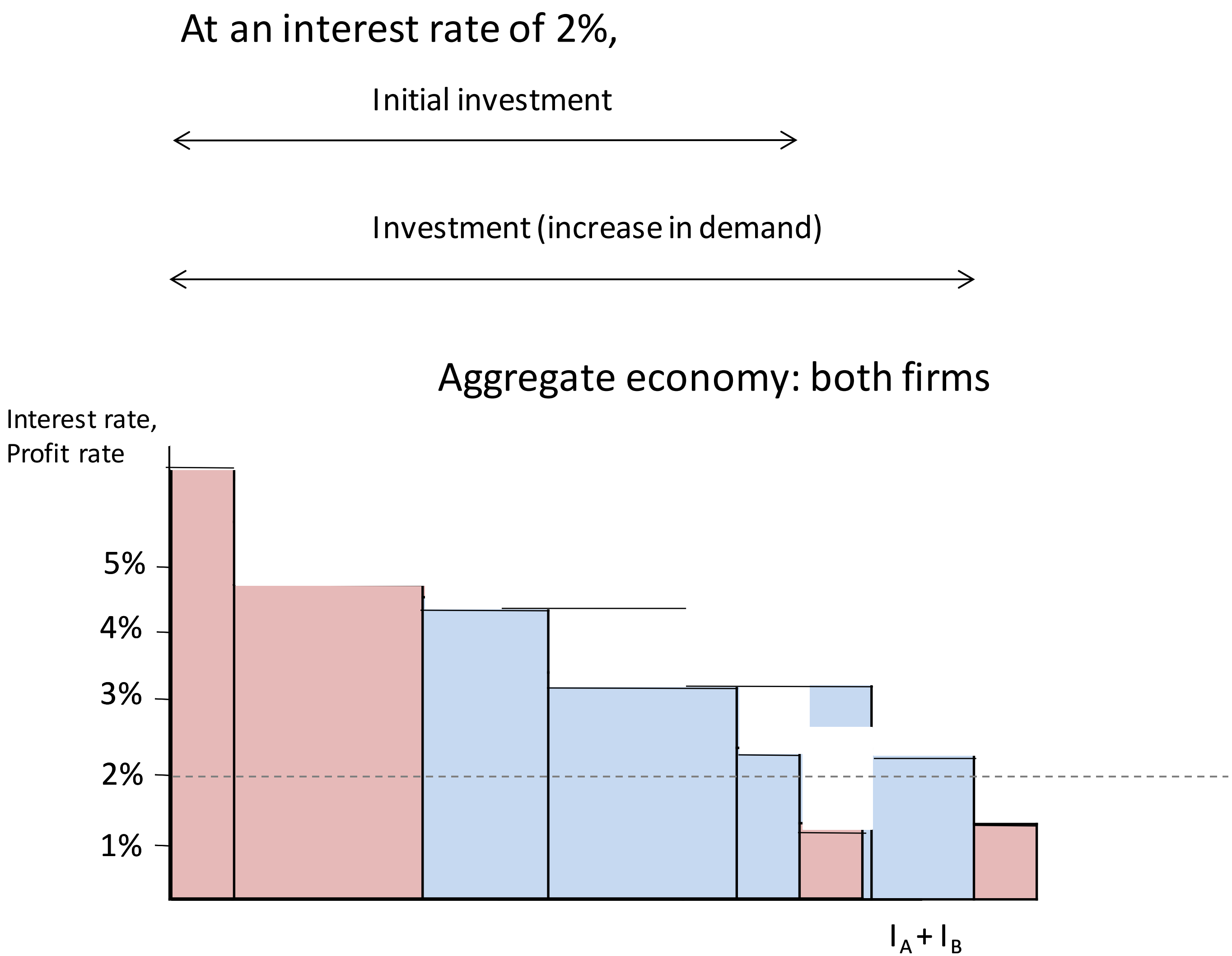


Figure 14.10c. Aggregate investment function: Effects of the interest rate and profit expectations.

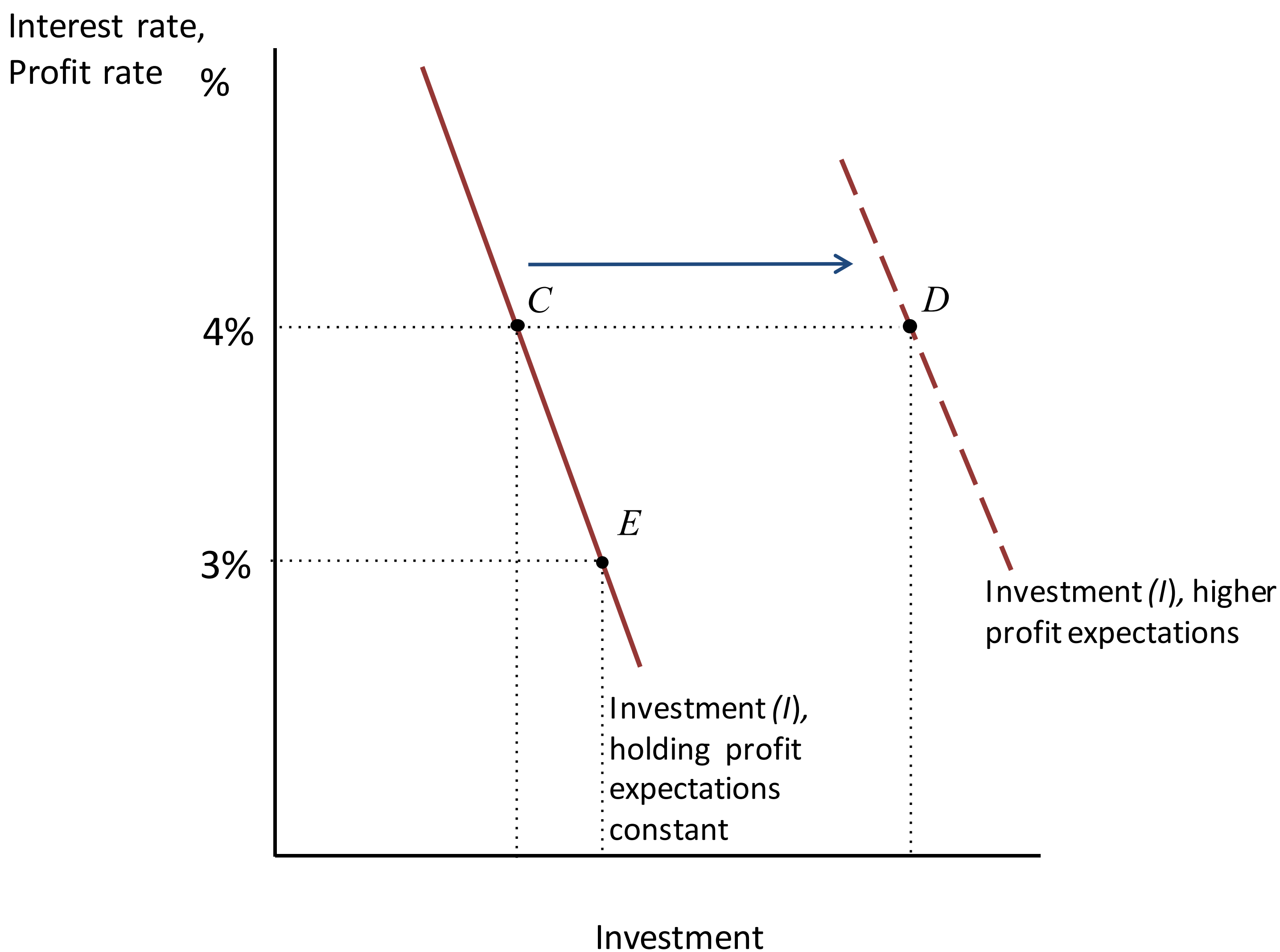
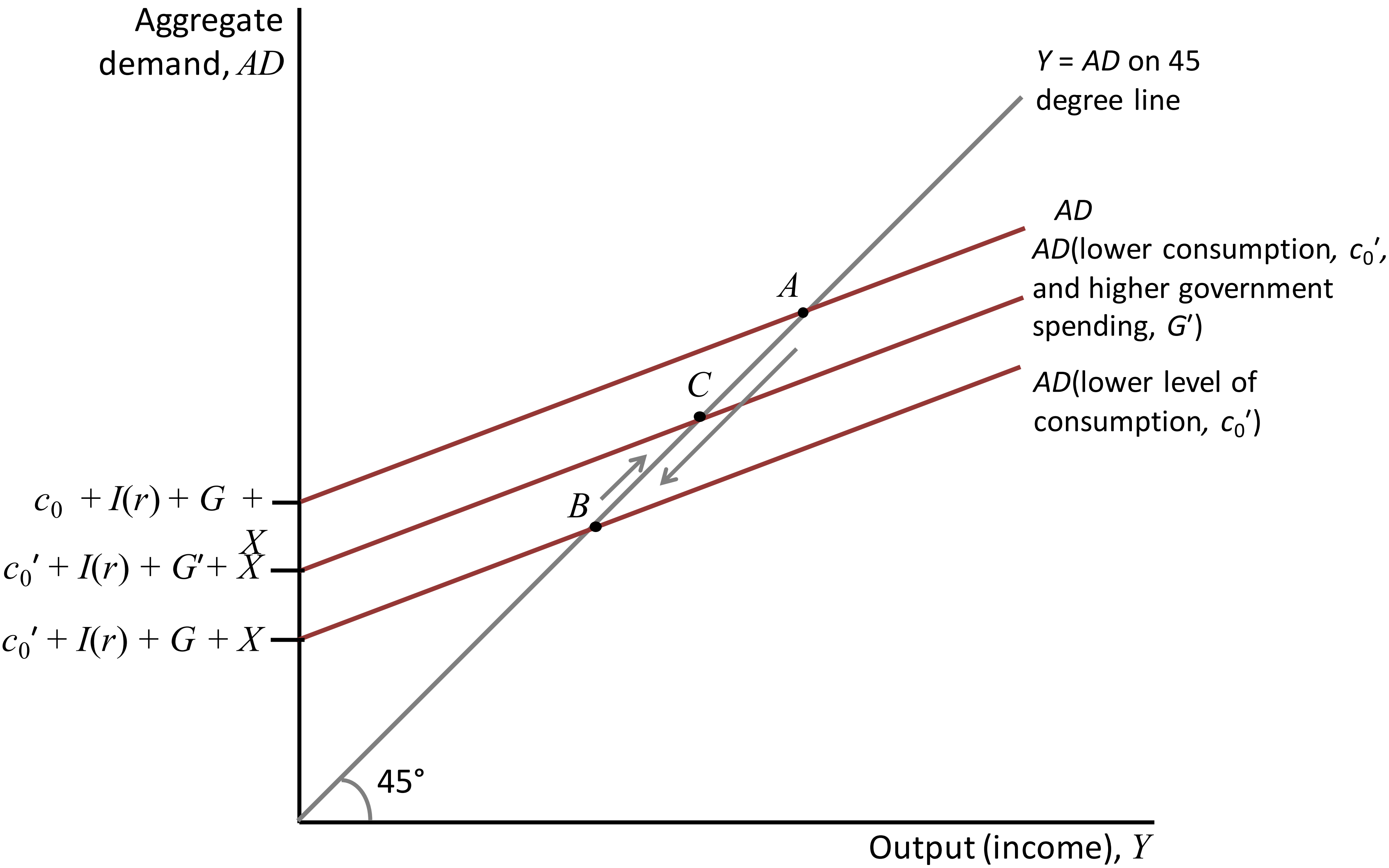
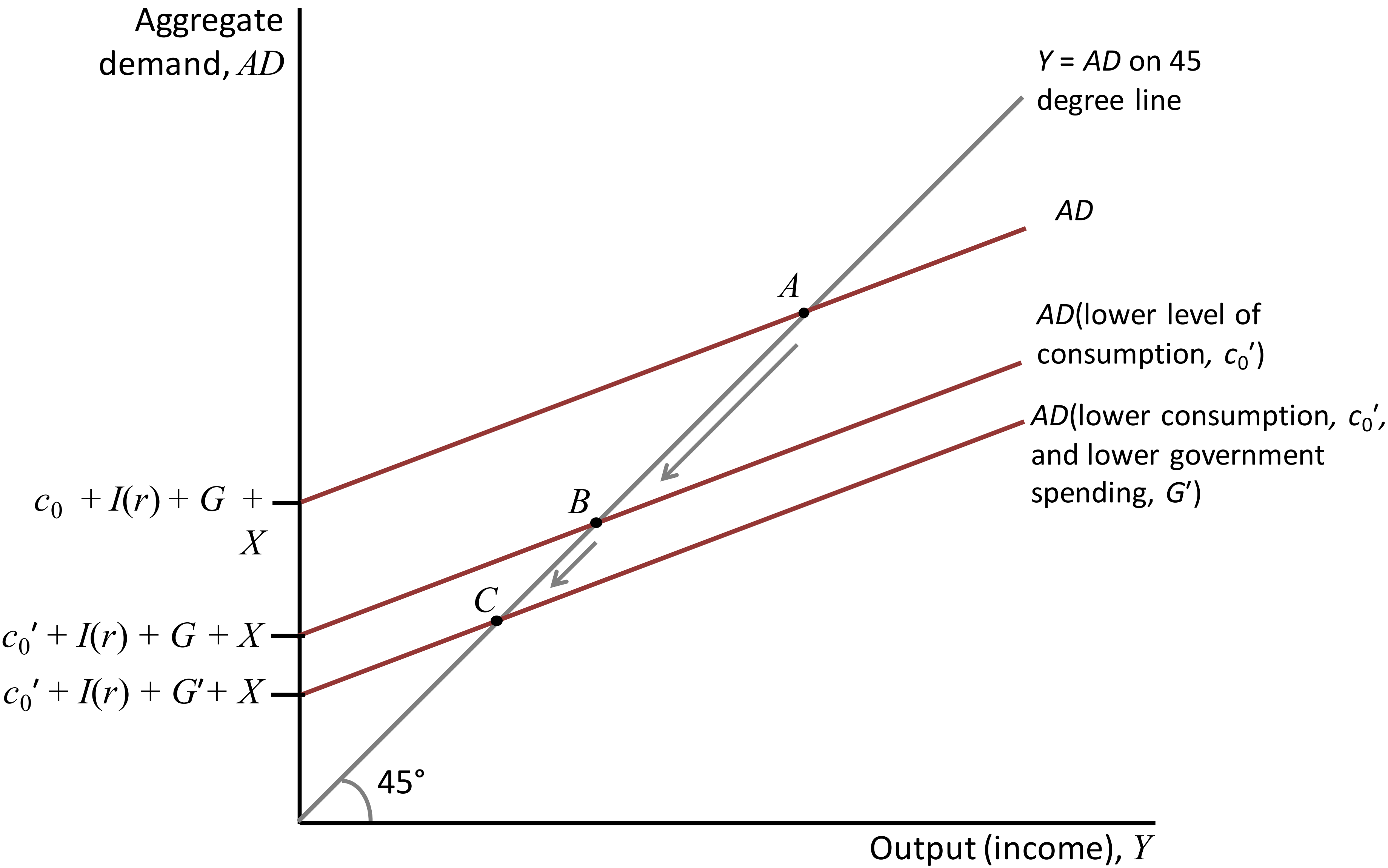


Figure 14.11a.



Note: $AD = c_0 + c_1(1 - t)Y + I(r) + G + X - mY$

Figure 14.11b. Government austerity can worsen a recession.



Note: $AD = c_0 + c_1(1 - t)Y + I(r) + G + X - mY$

Figure 14.12. The role of the private sector and the government in the business cycle.

	Dampening mechanisms offset shocks (stabilising)	Amplifying mechanisms reinforce shocks (may be destabilising)
Private sector decisions	• Consumption smoothing	• Credit constraints limit consumption smoothing • Rising value of collateral (house prices) can increase wealth above the target level and raise consumption • Rising capacity utilization in a boom encourages investment spending, adding to the boom
Government and central bank decisions	• Automatic stabilizers (e.g. unemployment benefit) • Stabilization policy (fiscal or monetary)	• Policy mistakes such as limiting the scope of automatic stabilizers in a recession or running deficits during low demand periods while not running surpluses during booms.

Figure 14.13. UK government debt as a percentage of GDP (1700-2014).

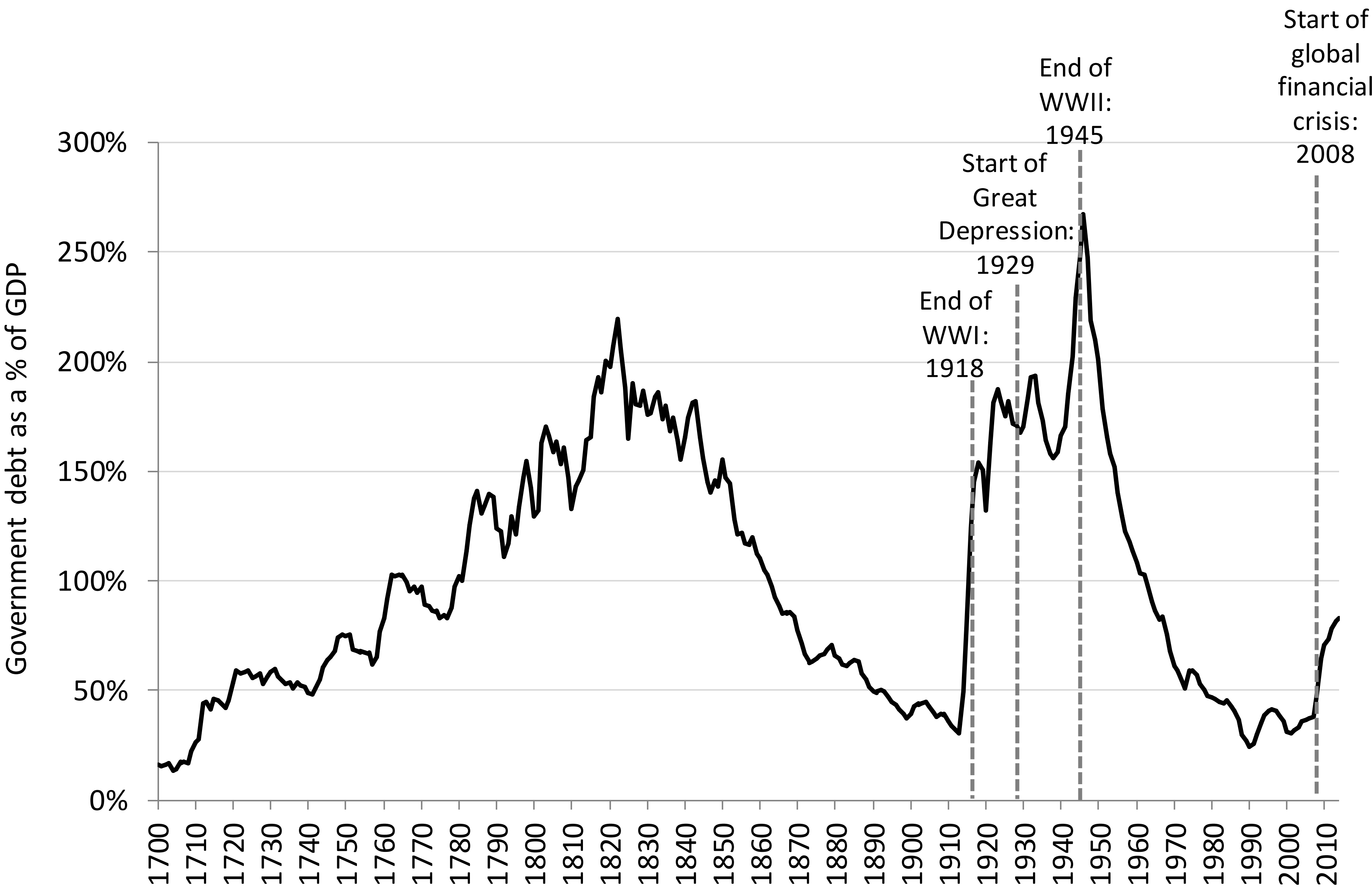


Figure 14.15. The supply side of the aggregate economy: The labour market.

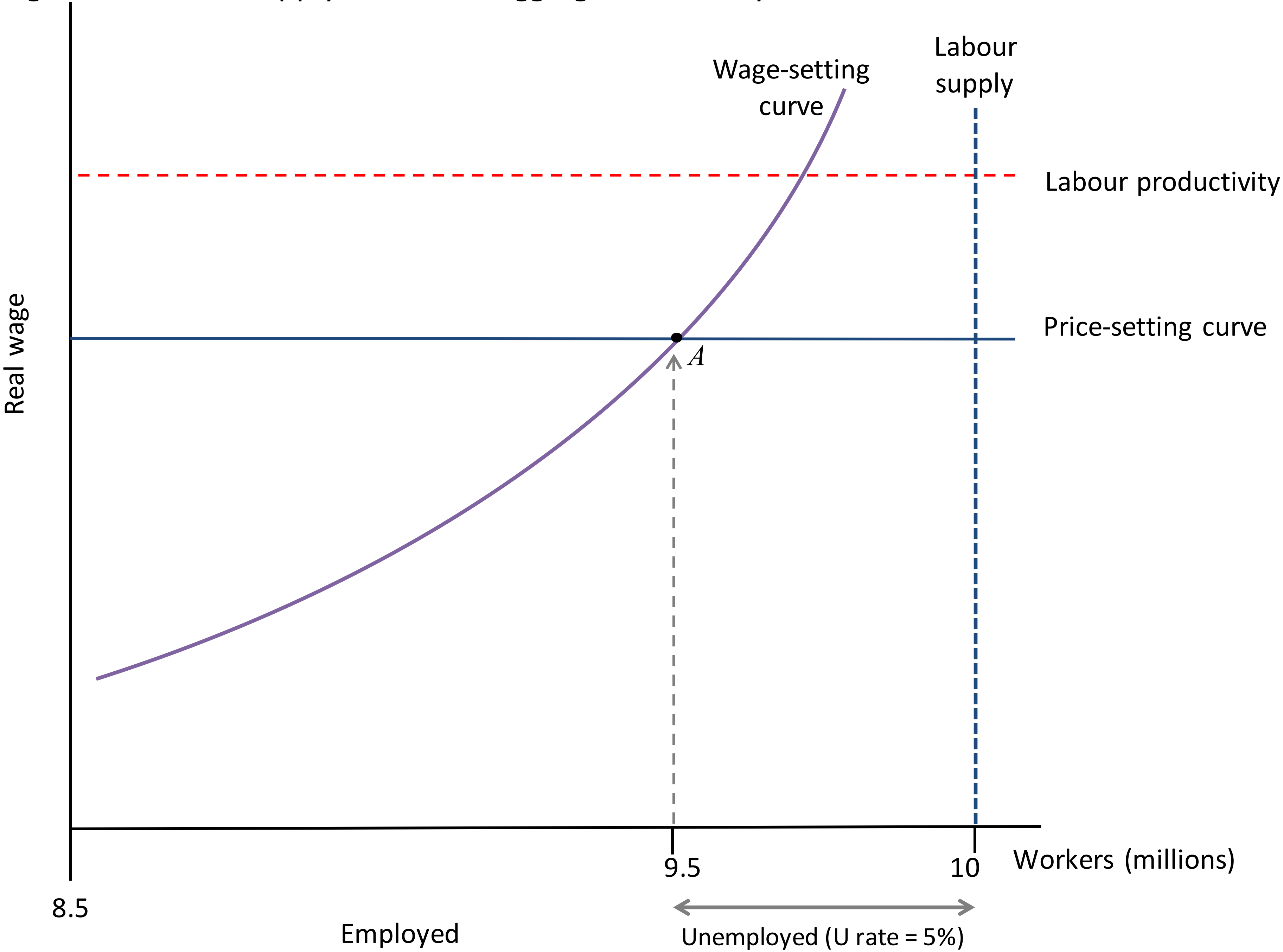


Figure 14.16. The supply side and the demand side of the aggregate economy.

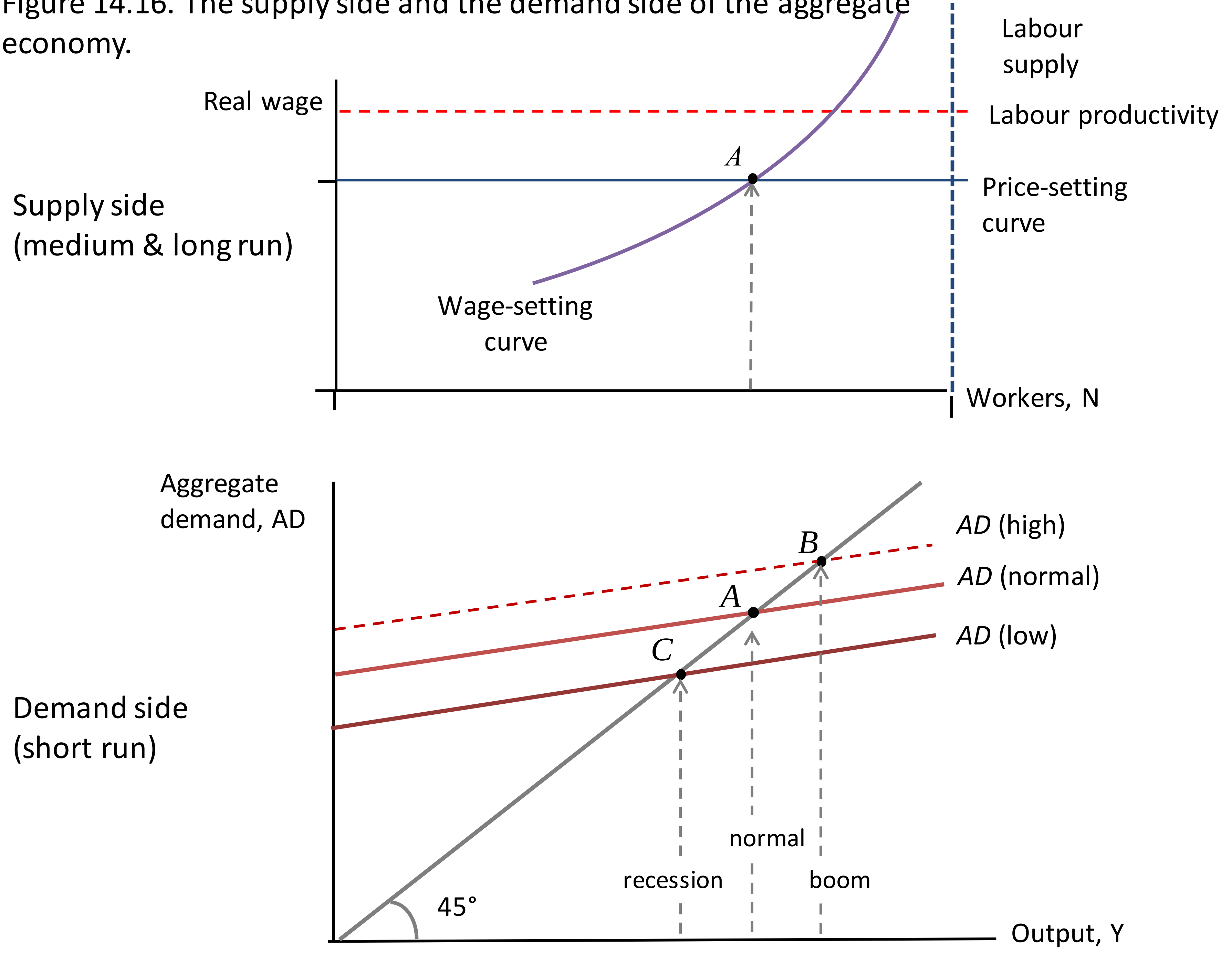


Figure 14.17. Business cycle fluctuations around equilibrium unemployment.

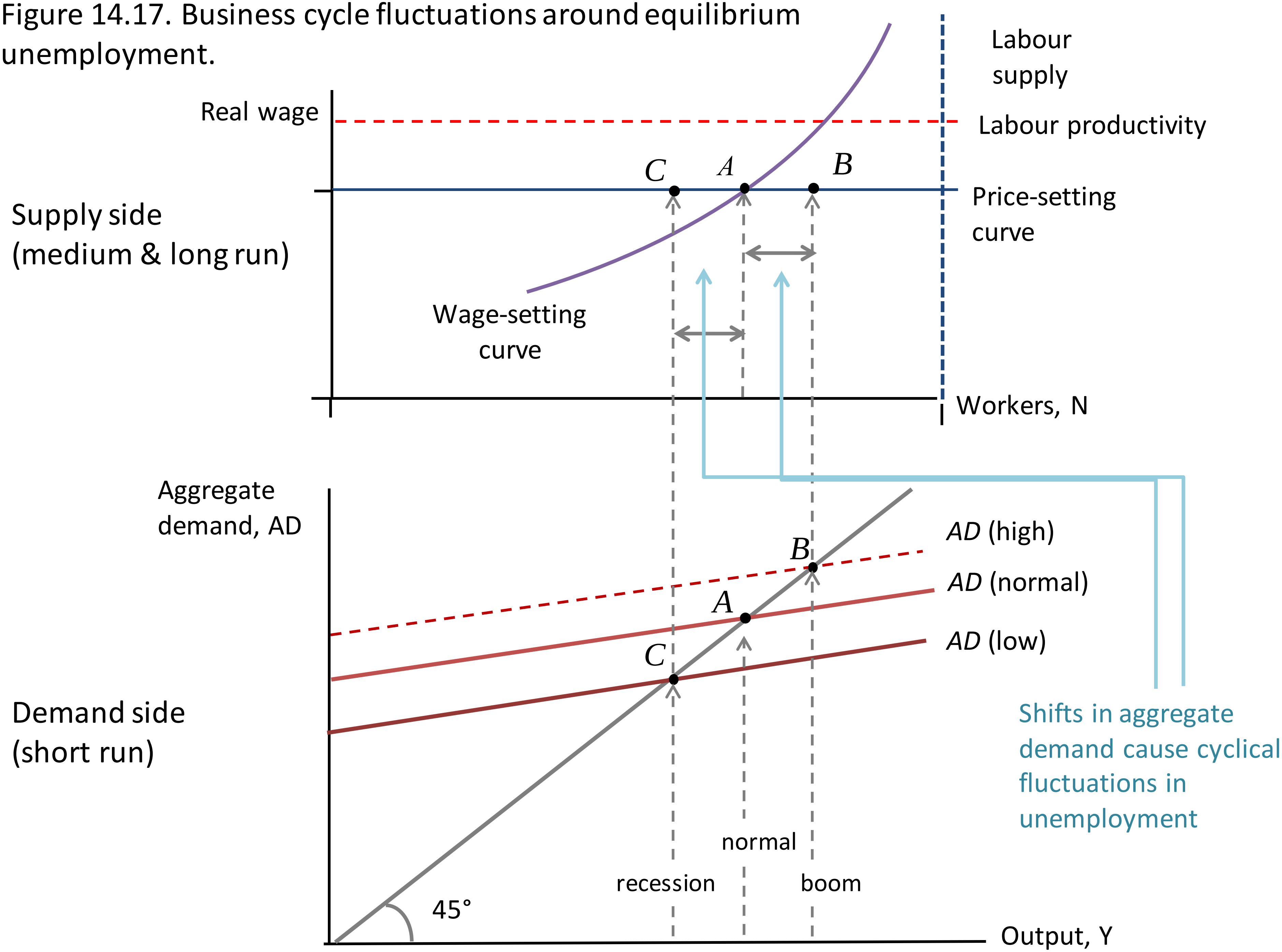


Figure 14.18. Models to study the aggregate economy.

UNIT	RUN	WHAT IS EXOGENOUS?	WHAT IS ENDOGENOUS?	PROBLEM TO BE ADDRESSED	APPROPRIATE POLICIES	MODEL TO USE
12, 13	Short	Prices, wages, capital stock, technology, institutions	Employment, demand, output	Demand shifts affect unemployment	Demand-side	Multiplier
13, 14	Medium	Capital stock, technology, institutions	Employment, demand, output, prices, wages	Demand and supply shifts affect unemployment, inflation and equilibrium unemployment	Demand-side, supply-side	Labour market; Phillips curve
15	Long	Technology, institutions	Employment, demand, output, prices, wages and capital stock	Shifts in profit conditions and changes in institutions affect equilibrium unemployment and real wages	Supply-side	Labour market model with firms neither entering nor leaving