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## What is Aggregate Demand

- **Aggregate Demand** = a metric of overall demand for *all* goods
  - You can think of it as a **demand schedule** of all the goods and services people are willing to purchase at different price levels
    - \* The same relation applies
      - Increasing price yields lower quantity demanded
      - Decreasing price yields higher quantity demanded
  - A useful way of looking at it is that aggregate demand is *really* just real GDP
    - \* This actually makes sense, because it is basically just the market value of all goods at any given time

$$AD = C + I + G + \Sigma X$$

- \* where  $C$  is consumer spending,  $I$  is investment,  $G$  is government spending, and  $\Sigma X$  is net exports
- You can construct a demand curve using **price level(PL)** and **Real GDP** just like with price and quantity demanded

## Why is the Aggregate Demand Curve Downward-Sloping?

1. **Wealth Effect** = a change in price level changes the purchasing power of a dollar, and thus the quantity of transactions changes
  - Increasing price yields lower “GDP demanded”
  - Decreasing price yields higher “GDP demanded”
2. **Interest-Rate Effect** = a change in price level changes interest rates that lenders charge
  - If price level increases, the lend is more risky, so a higher interest rate is charged
  - If price level decreases, the lend is less risky, so a lower interest rate can be charged
3. **Foreign Trade Effect** = a change in domestic price level invokes a kind of substitution effect wherein foreign goods are bought more or less
  - If domestic price level increases, GDP demanded(which doesn’t include foreign production) will decrease because consumers are purchasing foreign goods
  - If domestic price level decreases, GDP demanded(which includes domestic production) will increase because consumers are purchasing more domestic goods

## Shifters of Aggregate Demand

1. Change in consumer spending
    - Can be caused by many things
      1. Change in disposable income of consumers
      2. Expectations about future economic growth or contraction
        - If people are fearful of a recession, they won't spend as much
      3. Consumer debt
      4. Changes in consumer taxes
  2. Change in investment spending
    - Can be caused by many things
      1. Change in interest rates
      2. Expectations about future demand trends
        - If a new industry pops up and shows potential for growth, investment will increase
      3. Changes in labor productivity or automation
        - If productivity(output vs input ratio) increases, companies will invest to take advantage of that
      4. Changes in business taxes
  3. Change in government spending
    - Is only caused by a change in government expenditures
      - *e.g.* Buying more drones to bomb Libya with
  4. Change in net exports
    - Can be caused by many things
      1. Change in exchange rates
        - If the USD->Euro exchange rate changes, the purchasing power of each respective currency changes, and net exports change
      2. Change in domestic economic well-being
        - Generally, countries with high GDP-per-capita spend more on foreign goods
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## Aggregate Supply

- **Aggregate supply** = the quantity of goods and services businesses will produce(Real GDP) at certain price levelsj

- Has different behavior depending on time interval
  - \* **Short-run aggregate supply** = input costs(wages, natural resources, etc) do not increase as price level increase
    - If there is a right shift in aggregate demand, businesses can generate more profit, so they scale production
  - \* **Long-run aggregate supply** = input costs(wages, natural resources, etc) *will* increase as price level increases
    - If there is a right shift in aggregate demand, businesses can scale for more profit, but eventually input costs will rise

### Shifters of Aggregate Supply

1. Change in input costs
  - **Supply shocks** = some event that rapidly affects the availability of some good
2. Change in taxes, regulations, or subsidies
3. Change in productivity