

2017-02-27

## 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 levels

- 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

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### Inflationary and Recessionary Gaps

- **Inflationary gap** = a situation in which the equilibrium point on the AD-AS graph is to the right of the LRAS line
- **Recessionary gap** = a situation in which the equilibrium point on the AD-AS graph is to the left of the LRAS line
  - Is generally caused by a shift in AD, but can be caused by a shift of AS
  - **Stagflation** = a situation caused by a negative supply shock that stagnates growth and causes inflation
    - \* Is caused by a leftward shift of aggregate supply

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## Aggregate Supply In the Long Run

- Generally, a shift of aggregate demand will correspond with a long-term opposite shift in aggregate supply
    - For example, an increase in AD will result in a higher equilibrium price, and eventually input costs will increase(i.e. wage pressure) causing a decrease in AS
    - If AD decreases, equilibrium price will decrease, so producers will scale their production down
      - \* With less demand for inputs(labor, resources, etc), their price will go down
        - That decrease in input costs causes an increase in AS
  - **Capital stock** = the amount of capital goods purchased or produced by an economy to increase output
    - This is the *only* thing that can shift the LRAS line
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2017-03-03

## Classical Economics vs Keynesian Economics

- **Classical economics** = a theory of economics developed by Adam Smith and Hayek
    - Basic premise is that AS is always a vertical line
      - \* In other words, producers are constantly trying to produce at max level
        - Thus, AS is a vertical line determined by labor productivity and resources
    - Touts that government intervention is *inefficient*; that the market will regulate itself
  - **Keynesian economics** = a theory of economics developed by Keynes
    - Basic premise is that AS is a horizontal until it meets with demand, where it starts going up
    - **Sticky wages** = a characteristic of input costs to stay relatively constant
  - **Intermediate range** = a section of upward sloping AS curve meant to link the classical and keynesian AS curve
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### Phillip's Curve

- **Phillip's curve** = a graph that demonstrates an inverse relationship between inflation and unemployment
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2017-03-07

### Fiscal Policy

- **Car analogy** = a model of the economy that states a car is analogous to the entire economy
  - *You could go really fast, but its not sustainable*
  - *You could go really slow, but you're losing out on potential*
  - *You should go at the "right" speed, because it maximizes growth & production without causing inflation*
  - In this scenario, gas mileage is like the LRAS curve
    - \* If you improve efficiency or reduce input costs, you can go at a faster speed without repercussions

### The Role of Consumers

- In this world, your duty is to *consume*
  - "The last remaning American passtime is... BUYING THINGS" — George Carlin
  - **Autonomous consumption** = a type of consumption that doesn't scale with disposable income
    - \* *e.g.*
      - Food
      - Gas
      - Clean water
  - **Disposable income** = the level of income that a person has to spend after autonomous consumption
  - **Dissaving** = the effect when incomes are less than that required for autonomous consumption
    - \* As a result, people are actually *losing* money with time

## Government Action

1. **Fiscal policy** = actions taken by Congress to modulate economic growth or consumption
  - Essentially, Congress can change *spending* or *taxes*
  - **Discretionary Fiscal Policy** = the act of passing a *bill* to enact economic change
    - Takes a hideously long time, due to bureaucratic inefficiency
  - **Non-Discretionary Fiscal Policy** = mechanisms in bills that have already passed that enact economic change
    - Also called **Automatic stabilizers**
    - *e.g.*
      - \* Welfare = when unemployment rises, welfare programs will provide aid to stimulate consumption
      - \* Unemployment insurance = when unemployment rises, unemployment insurance ensures that individuals can still consume
      - \* Minimum wage = when labor costs dip, minimum wage ensures consumption doesn't fall too low
  - **Contractionary Fiscal Policy** = a form of fiscal policy that increases taxes to inhibit consumption/investment while decreasing government spending
    - Can technically be discretionary or non-discretionary, but is *usually* discretionary
  - **Expansionary Fiscal Policy** = a form of fiscal policy that decreases taxes to increase consumption/investment while increasing government spending
2. **Monetary policy** = actions taken by the Federal Reserve Bank to modulate economic growth or consumption