

Unit 03 Preview

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Aggregate Demand

The Wealth Effect

- Higher price levels reduce the purchasing power of money, which decreases the quantity of expenditures.
- Lower price levels increase purchasing power and increase expenditures

Interest Rate Effect

- When the price level increases, lenders charge higher interest to get a REAL return on their loans

Foreign Trade Effect

- When price levels rise, foreign buyers purchase fewer U.S. goods and Americans buy more foreign goods. X_n decreases.



Figure 1
An aggregate demand curve



Figure 1
An aggregate demand curve

Multipliers

- Marginal Propensity to Save (MPS); How much people save instead of consume when there is a change in income. Expressed as

$$MPS = \frac{\Delta \text{savings}}{\Delta \text{Disposable Income}}$$

- Marginal Propensity to Consume (MPC); How much people consume rather than saving when disposable income changes. Expressed as a fraction:

$$MPC = \frac{\Delta \text{consumption}}{\Delta \text{Disposable Income}}$$

- Spending Multiplier

$$\frac{1}{MPS} = \frac{1}{1 - MPC}$$

- Simple Tax Multiplier

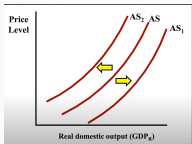
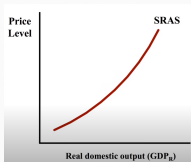
$$\frac{MPS}{MPC}$$



Short-Run Aggregate Supply (SRAS)

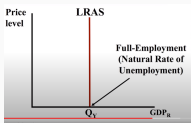
Things that can affect SRAS

- Change in the prices of resources
- Changes in taxes, subsidies, or regulations
- Change in productivity
- Expectations



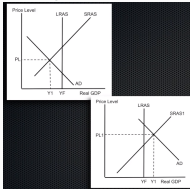
Long-Run Aggregate Supply (LRAS)

- The curve shows what we can produce at the natural rate of unemployment.



Equilibrium in the Aggregate Demand-Aggregate Supply (AD-DS) Model

- Puts aggregate demand and aggregate supply together.
- Recessionary gap doesn't necessarily mean there's a recession
- This unit revolves around shifting curves, specifically SRAS, AD1
- Positive supply shock: the short supply increase.
- Cost push inflation, supply shifts left, and demand-pull shifts right.



Change in the AD-AS Model in the Short Run

Long-Run Self Adjustment

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