

# Unit 03 Preview

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# Table of Contents

Aggregate Demand

Multipliers

Short-Run Aggregate Supply (SRAS)

Long-Run Aggregate Supply (LRAS)

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

Change in the AD-AS Model in the Short Run

Long-Run Self Adjustment

Fiscal Policy

Automatic Stabilizers

# Aggregate Demand

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## 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

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- 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

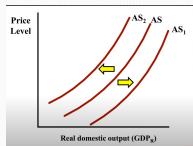
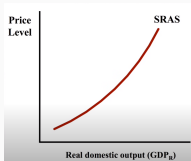
$$\frac{MPS}{MPC}$$



## Short-Run Aggregate Supply (SRAS)

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



## Long-Run Aggregate Supply (LRAS)

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

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## **Change in the AD-AS Model in the Short Run**

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## Long-Run Self Adjustment

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## Fiscal Policy

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## **Automatic Stabilizers**

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