Unit 03 Preview

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October 12, 2021

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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

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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. Expressesed as a fraction:

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

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