MACRO - Lecture - 3

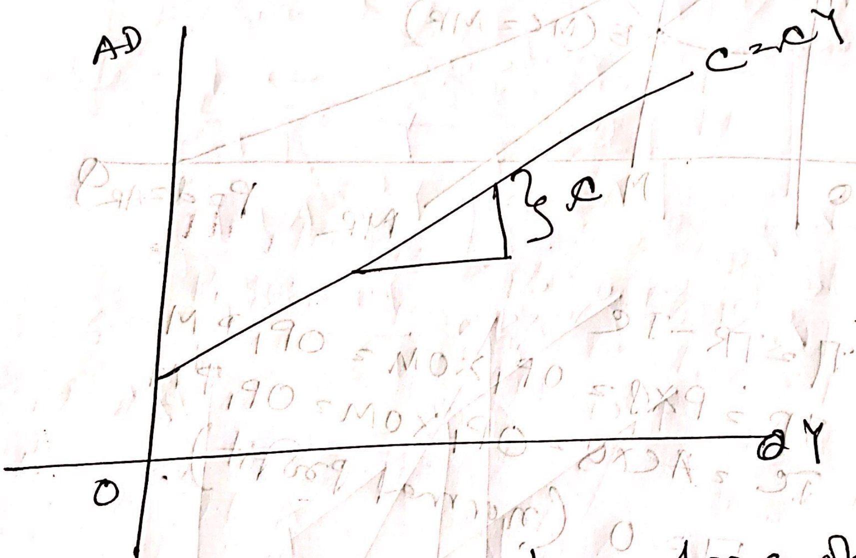
Consumption, Saving, Investment.

$C = cY$

where c = Marginal Propensity to Consume.

If c is 0.8 and $Y \uparrow$ by 100 tk

the $C = cY = 0.8 \times 100 = 80$ tk



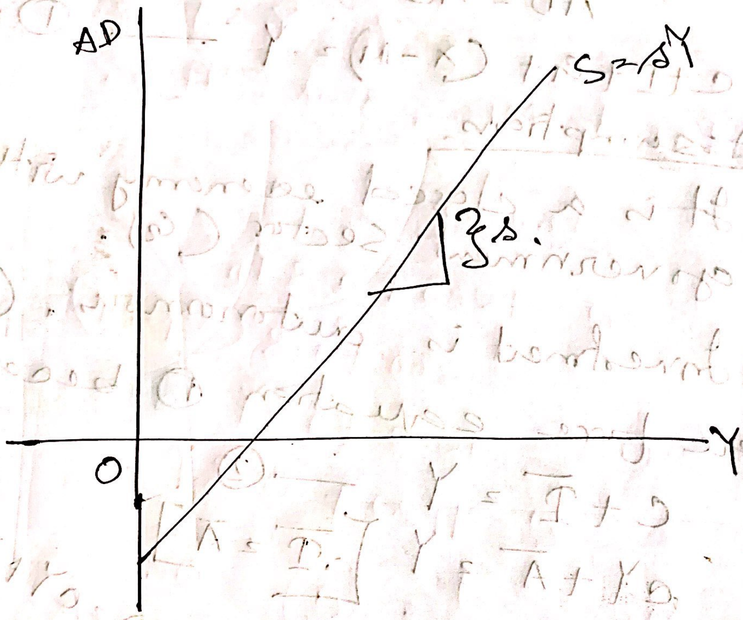
so c is also the slope of consumption function.

Now Saving $= S = C - Y = cY - Y = Y(1-c)$

$= sY$

s = Marginal Propensity to save = MPS

so if $c = 0.8$ the $S = sY = (1-c)Y = (1-0.8) \times 100$
$= 20$ tk.



Again,
$c + s = 1 + 1 - c = 1$
therefore, $0 < c, s < 1$

and if ~~MP~~ $c = 1$ then $s = 0$ and vice versa.

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Planned Investment.

$$AD = AS$$

$$C + I + G + (X - M) = Y \quad \text{—— ①}$$

Assumptions-

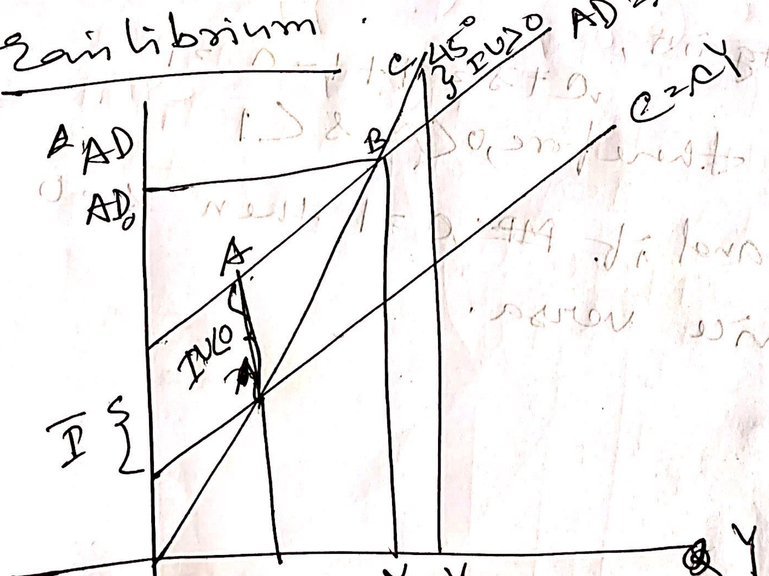
1) It is a closed economy with no government sector (G).
2) Investment is autonomous. ($\bar{I}$)

There fore equation ① becomes-

$$C + \bar{I} = Y \quad \text{—— ②}$$

$$cY + \bar{A} = Y \quad [\because \bar{I} = \bar{A}]$$

Equilibrium



45° = Income-Output line
Y_0 = Efficient level of output
~~at A, AD > AS so inventory > 0~~
~~C, AD < AS " " < 0~~

at A, AD > AS so inventory < 0
C, AD < AS. so " > 0
At point B, there is no inventory.

From B →

B $AD_0 = Y_0$

$$cY_0 + \bar{A}_0 = Y_0$$

$$Y_0 - cY_0 = \bar{A}_0$$

$$Y_0 (1-c) = Y_0$$

$$Y_0 = \frac{1}{(1-c)} \bar{A}_0$$

Both c and $\bar{A}_0$ are directly related to Y_0. the higher the consumption and investment, the higher the income.

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Given,

$C = 1200 + 0.8Y_D$ where $Y_D = Y - T$ and $T = 100$

Find MPC and MPS.

Answer

$C = 1200 + 0.8Y_D$

$= 1200 + 0.8(Y - T)$

$= 1200 + 0.8Y - 80$

$C = 1120 + 0.8Y$

$c = MPC = \frac{\Delta}{\Delta Y}(C) = 0.8$

$s = MPS = (1 - c) = (1 - 0.8) = 0.2.$

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