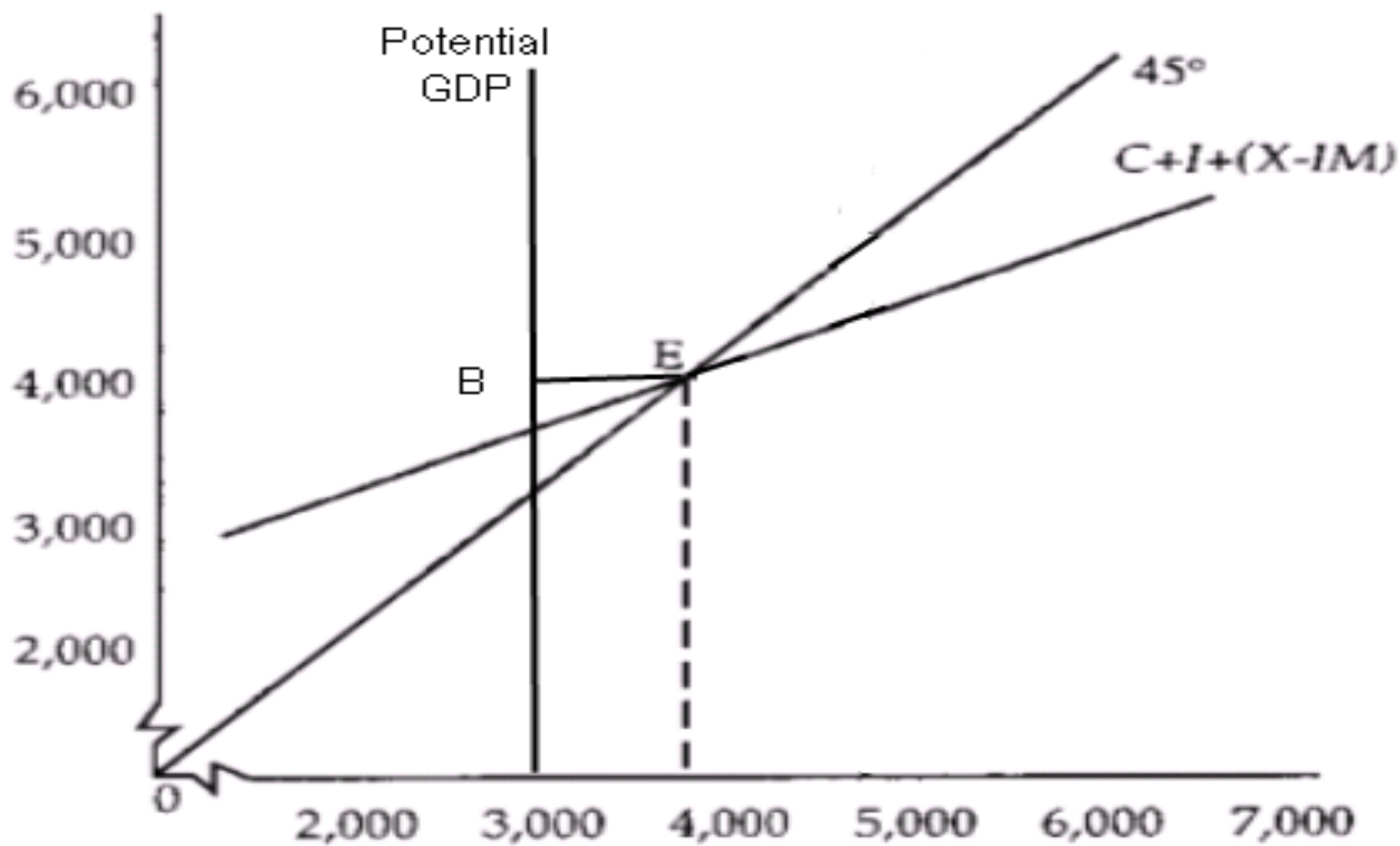


Real Expenditure
(billions of dollars per year)



1. GDP = ?

2. Is total spending larger than/smaller than/equal to Output?

3. Do Inventories fall, rise or remain unchanged?

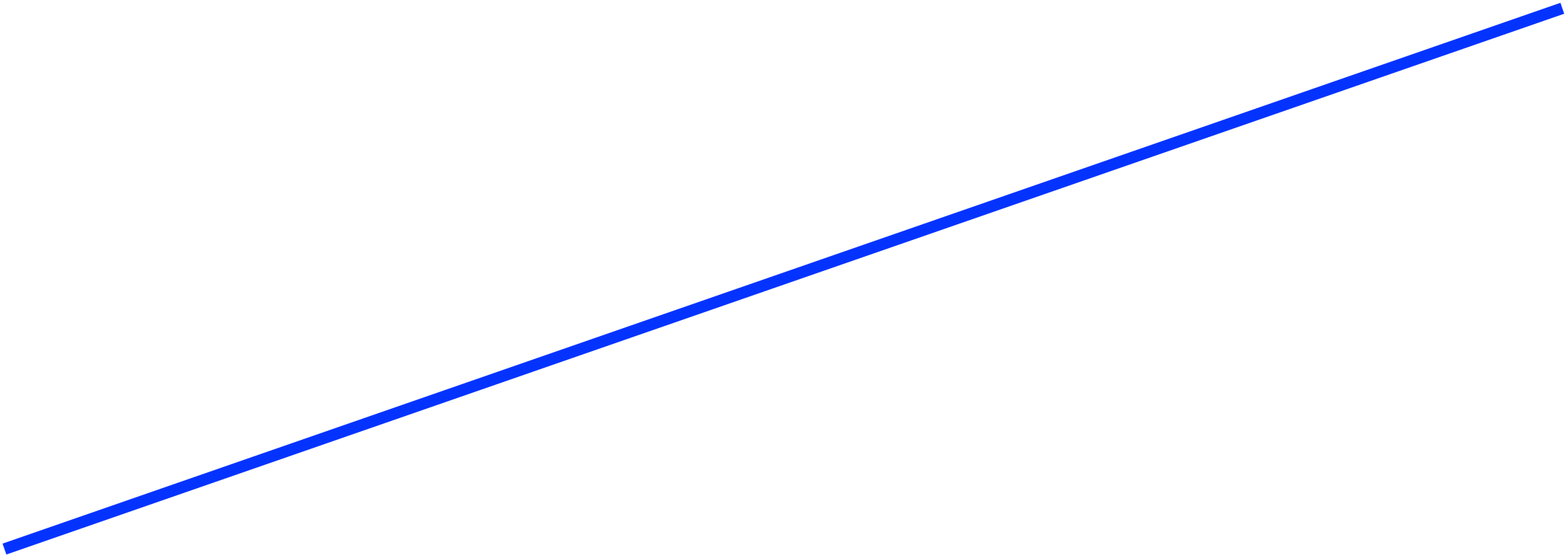
4. Does the economy experience a recessionary/inflationary gap?

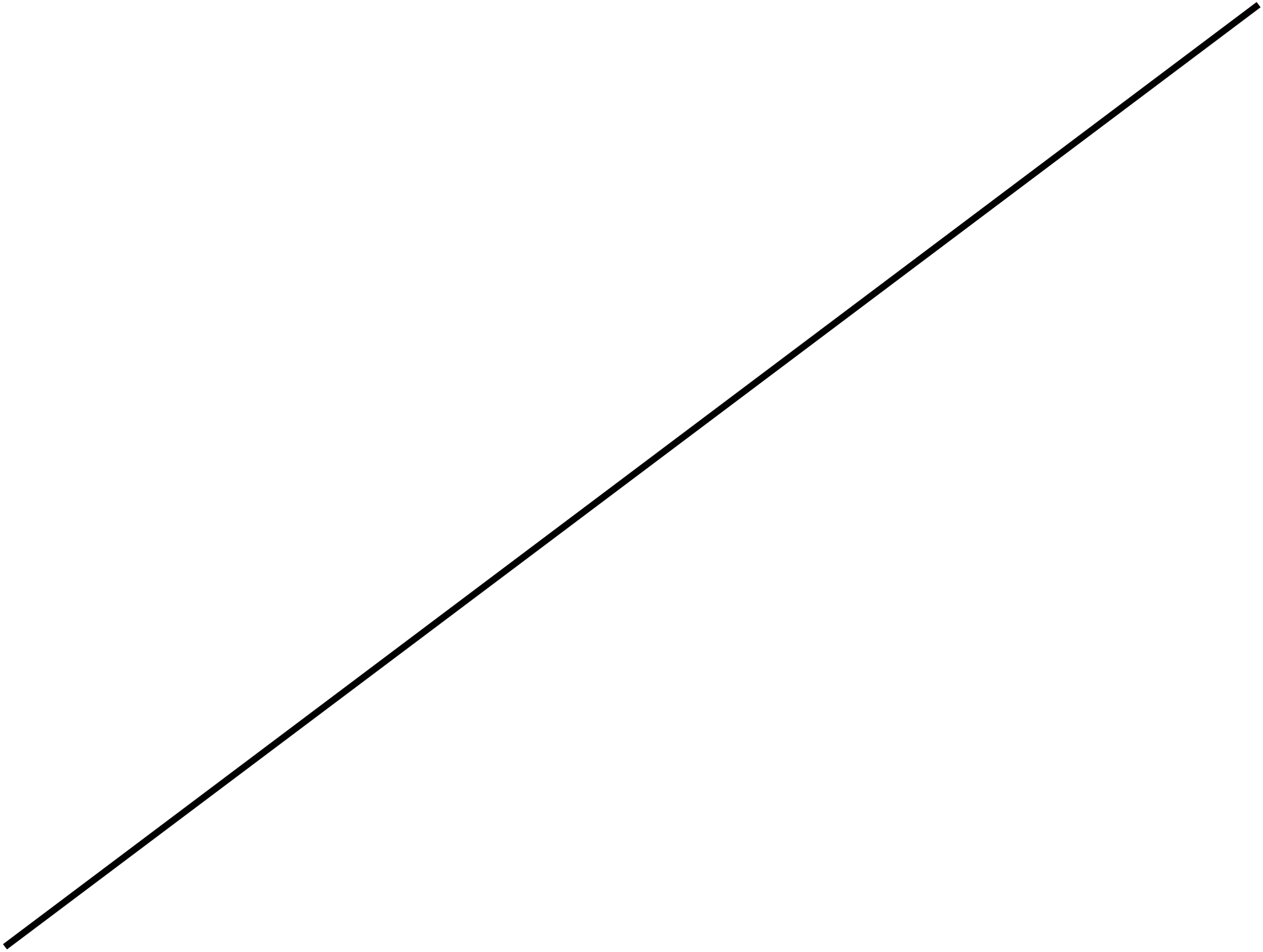
5. What is the size of the gap?

6. How can the gap be closed?



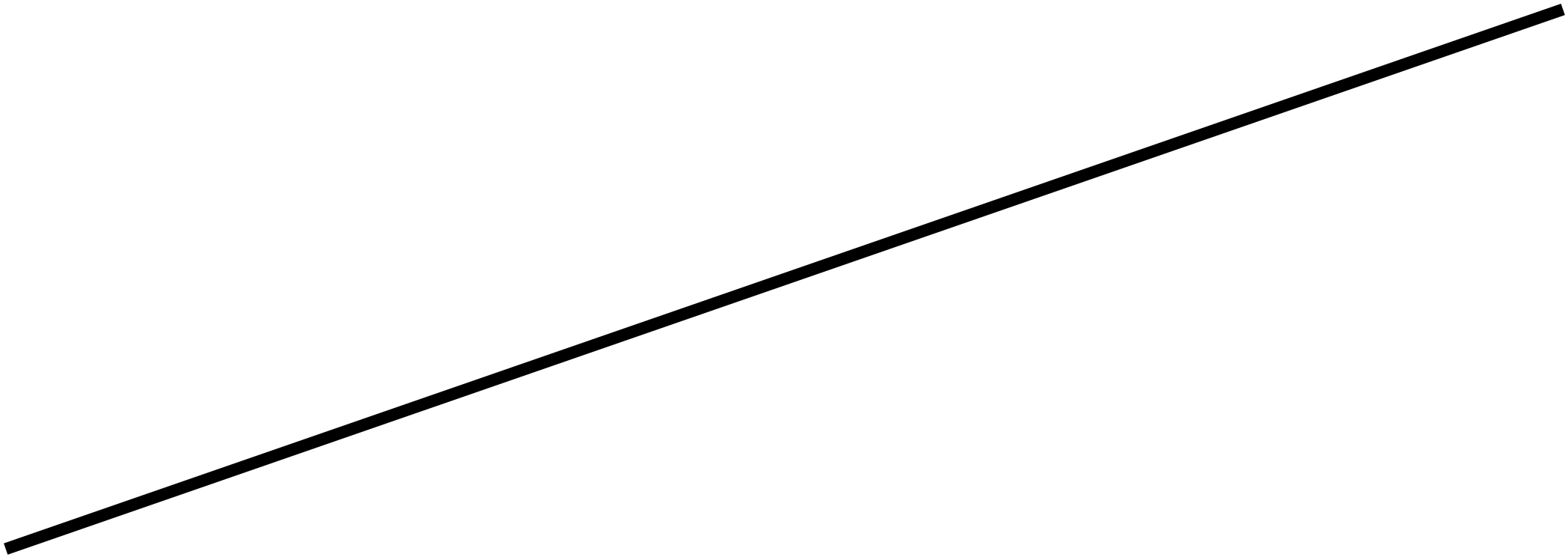
Assume the
Economy is at
Equilibrium













GDP=4,000

AE_1

450

$$AE = 4,000$$

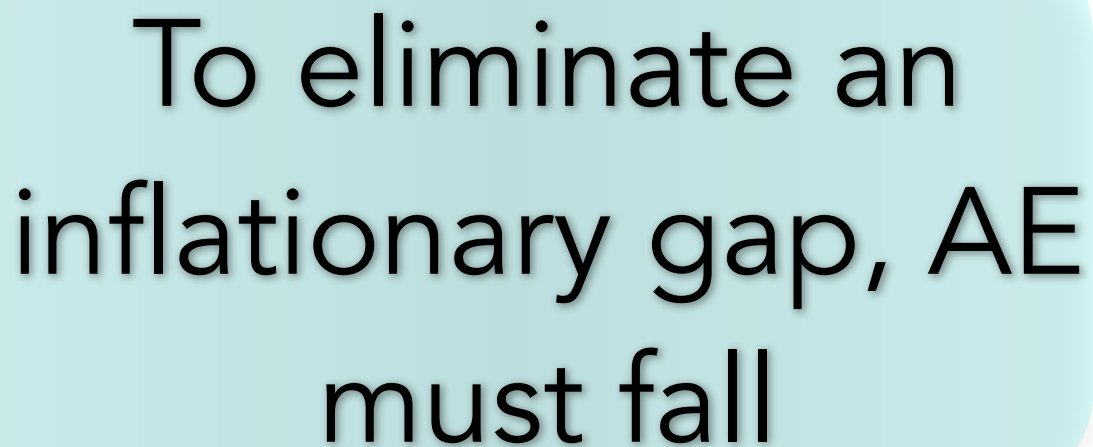
GDP=3,000







$$\text{Gap} = 3,000 - 4,000 = -1,000$$



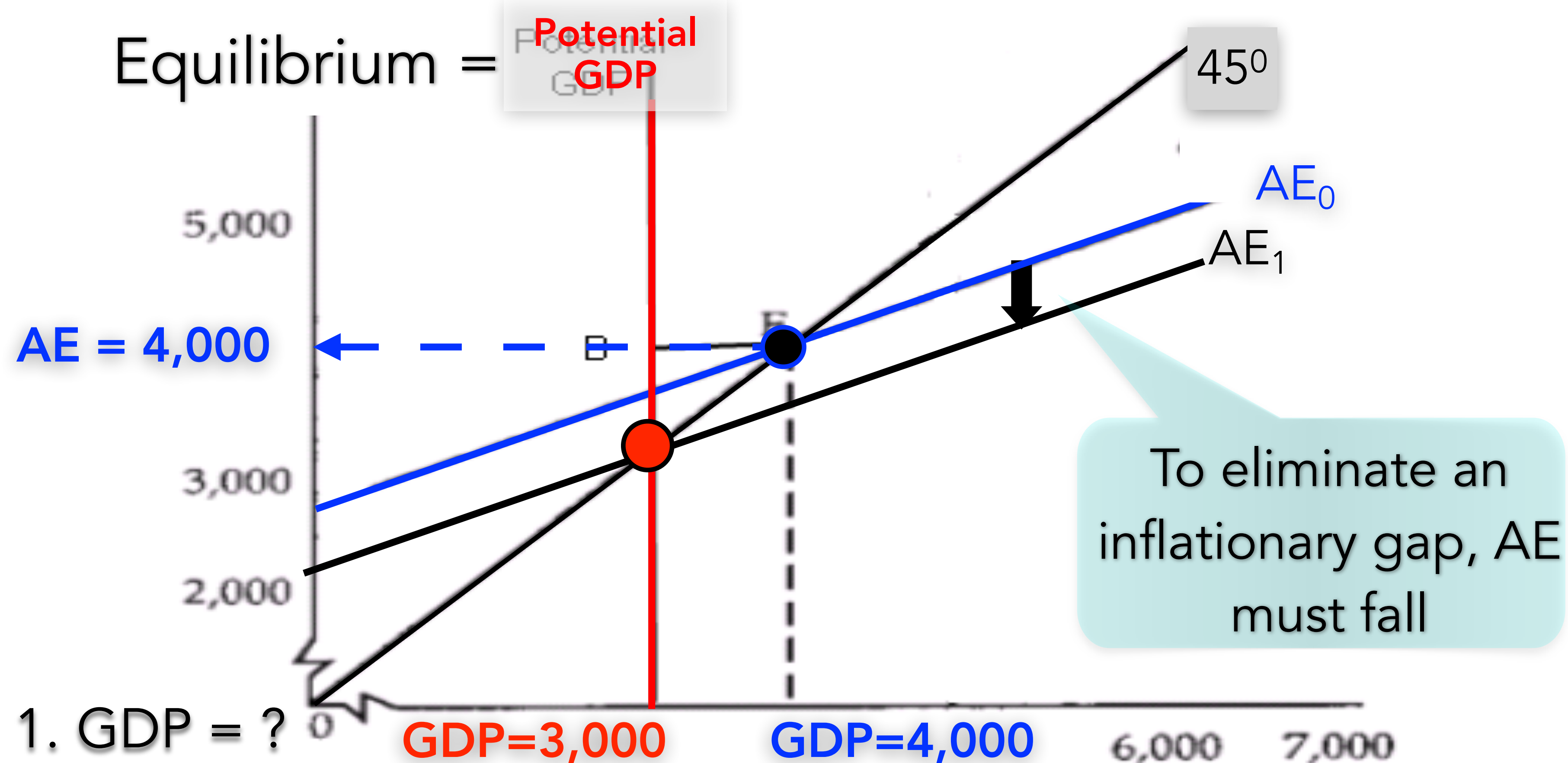
To eliminate an
inflationary gap, AE
must fall

Equilibrium =



AE₀

**Potential
GDP**



1. GDP = ?
2. Is total spending larger than/smaller than/equal to Output?
3. Do Inventories fall, rise or remain unchanged?
4. Does the economy experience a recessionary/inflationary gap?
5. What is the size of the gap? $\text{Gap} = 3,000 - 4,000 = -1,000$
6. How can the gap be closed?

