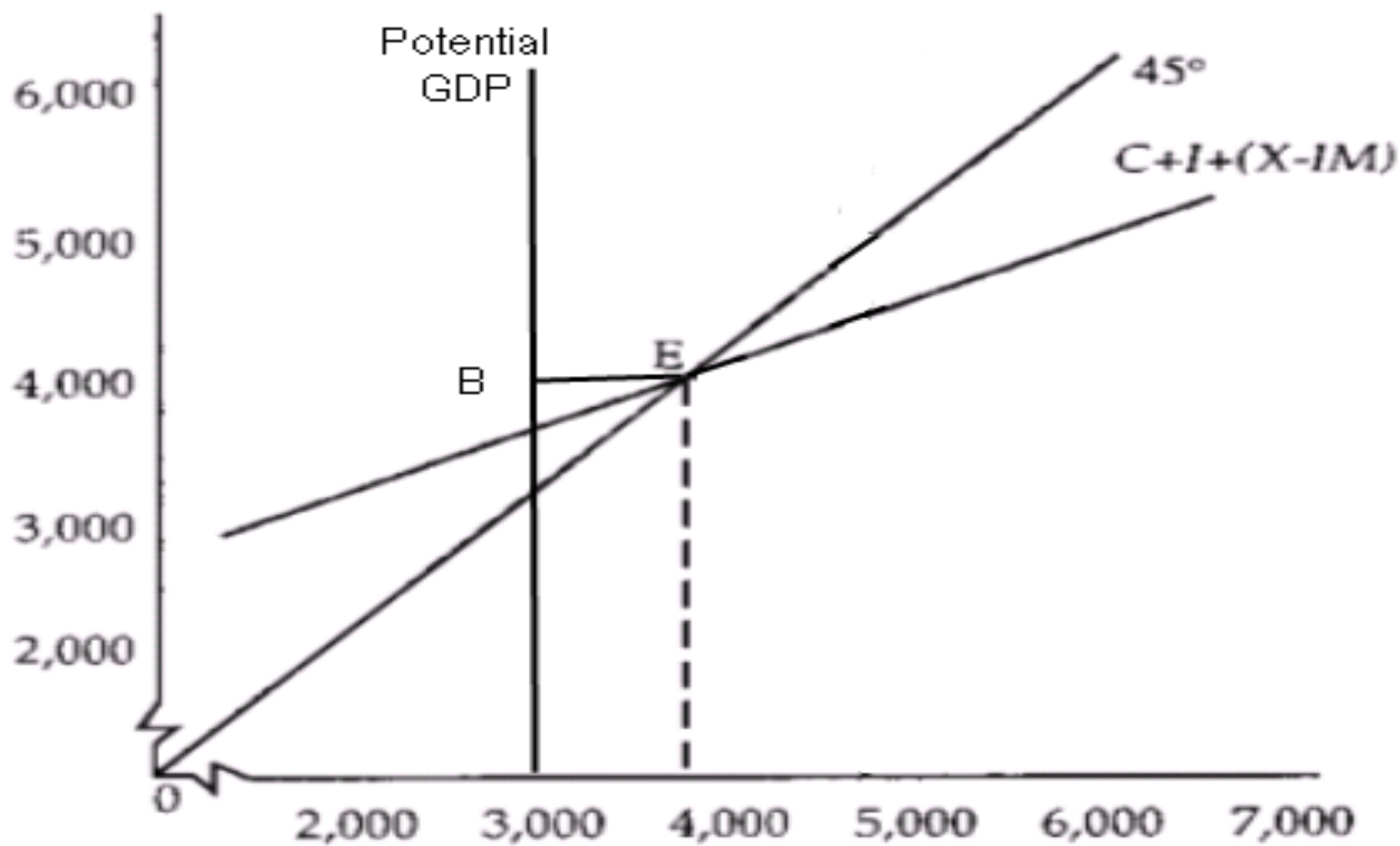




Real Expenditure  
(billions of dollars per year)



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?

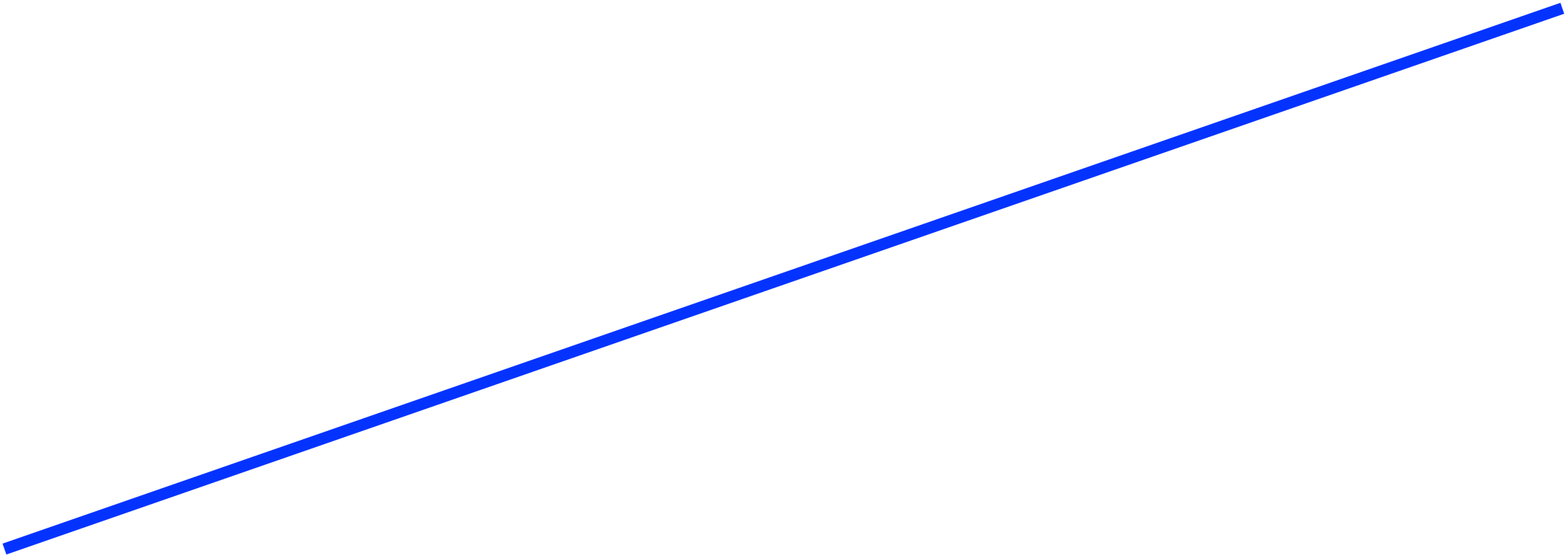
5. What is the size of the gap?

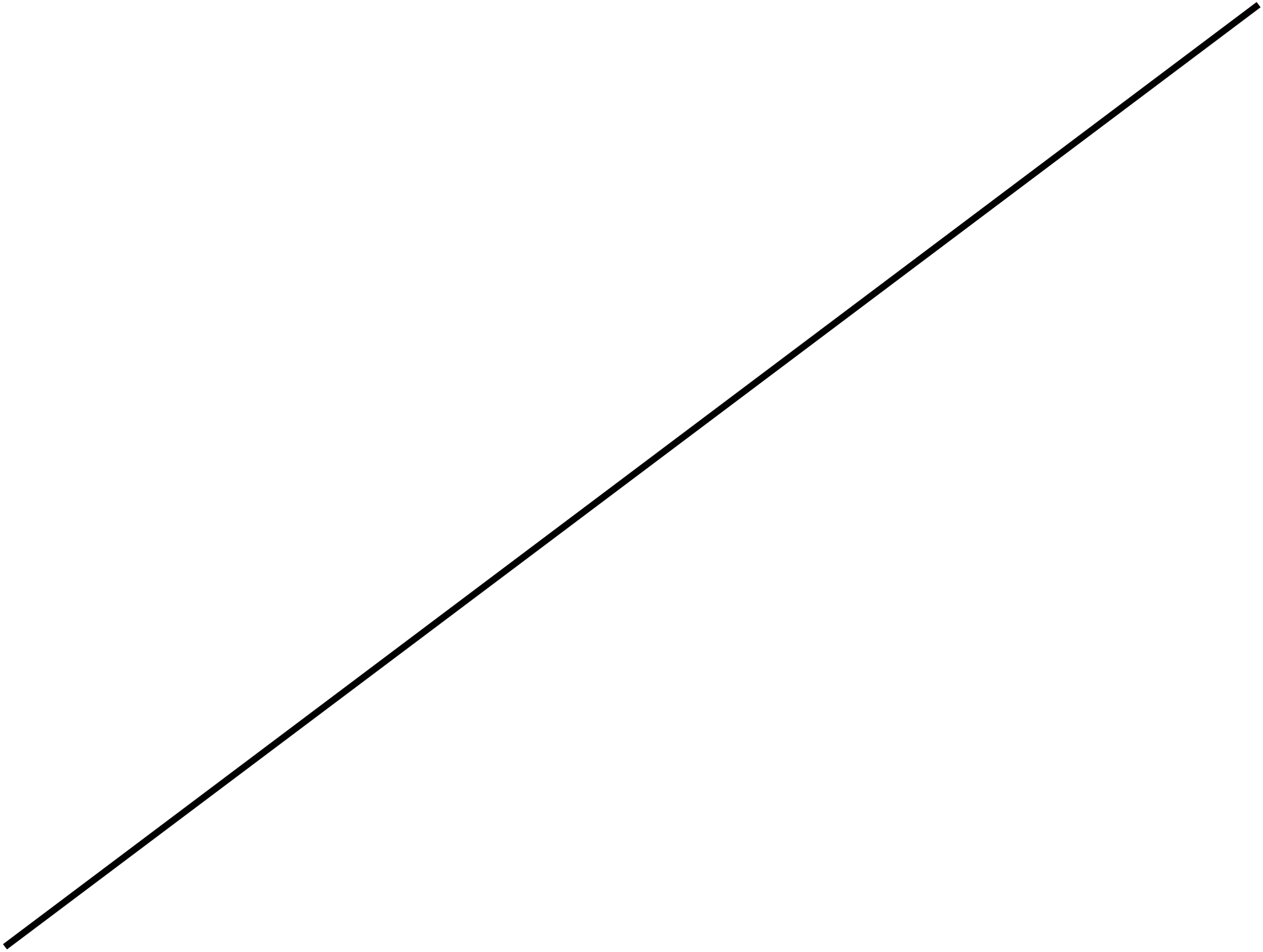
6. How can the gap be closed?





Assume the  
Economy is at  
Equilibrium

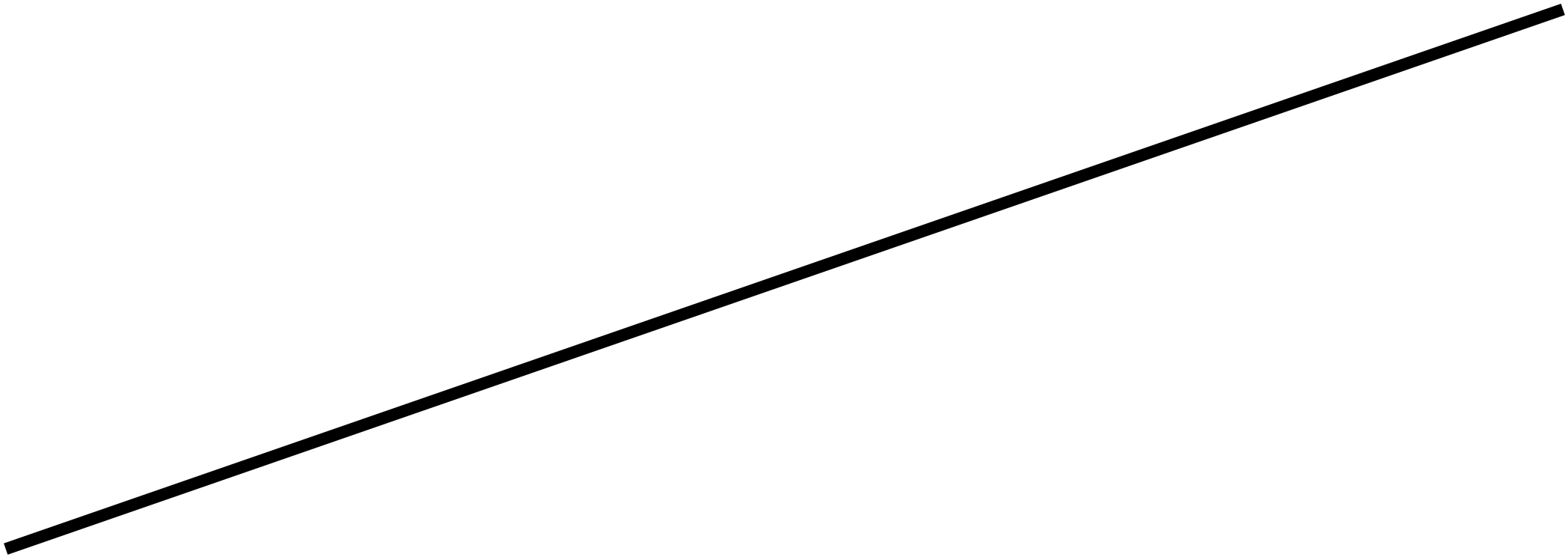
















**GDP=4,000**

$AE_1$

450

$$AE = 4,000$$

**GDP=3,000**

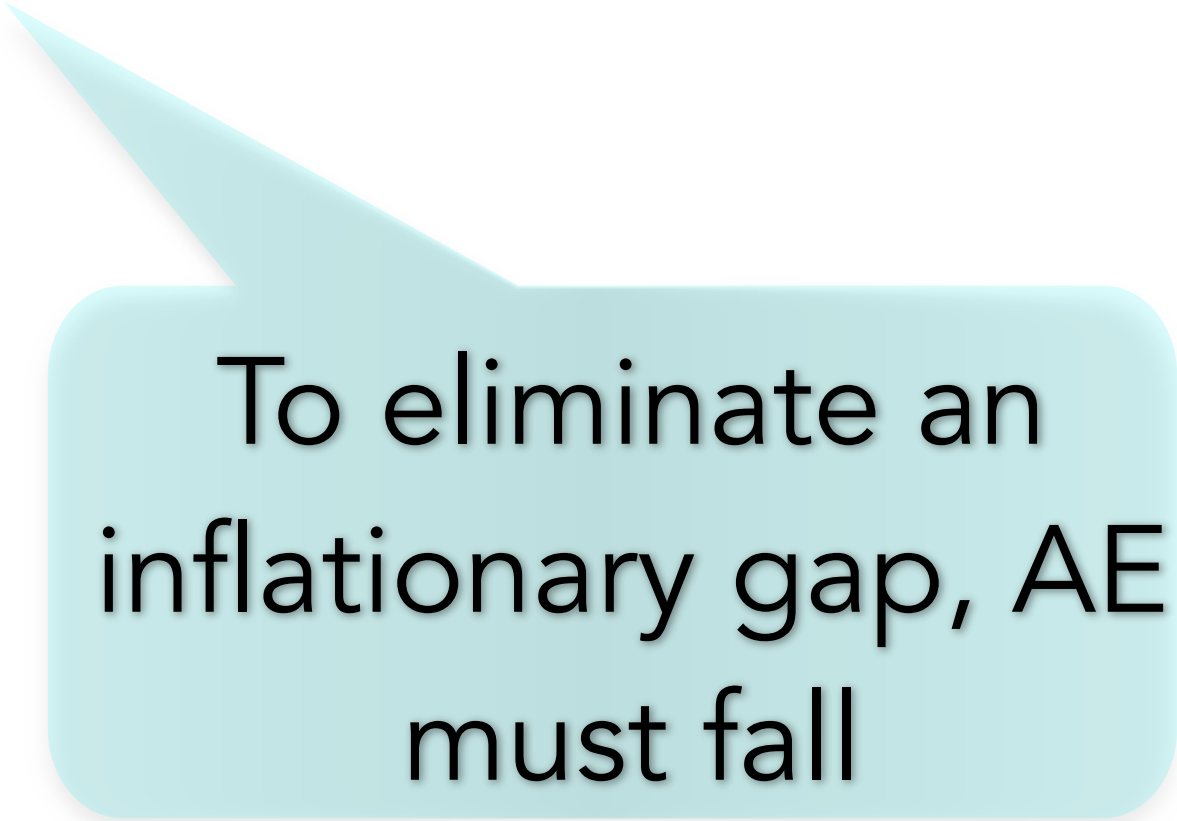








$$\text{Gap} = 3,000 - 4,000 = -1,000$$



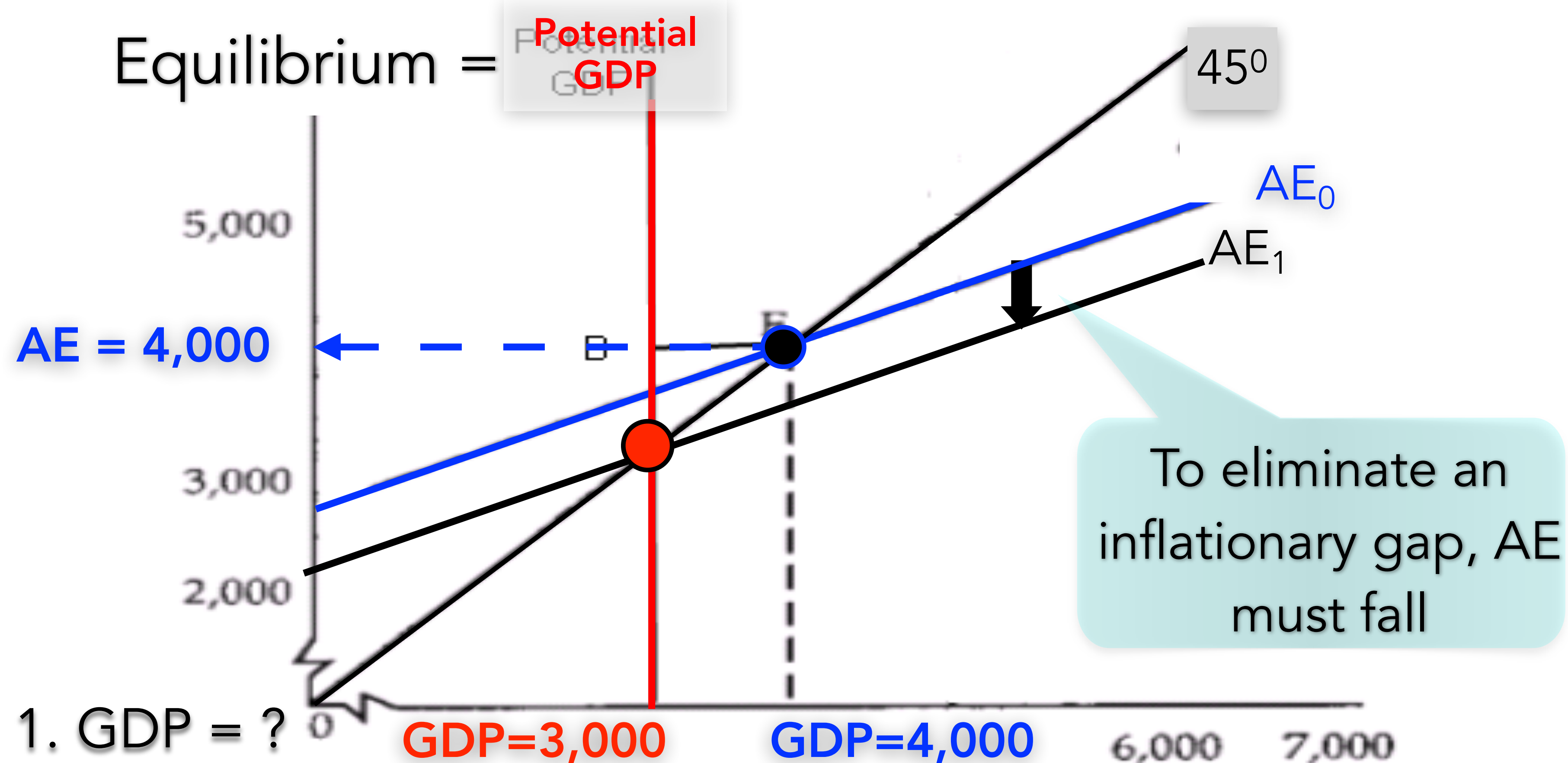
To eliminate an  
inflationary gap, AE  
must fall

Equilibrium =



AE<sub>0</sub>

**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?  $Gap = 3,000 - 4,000 = -1,000$
6. How can the gap be closed?

