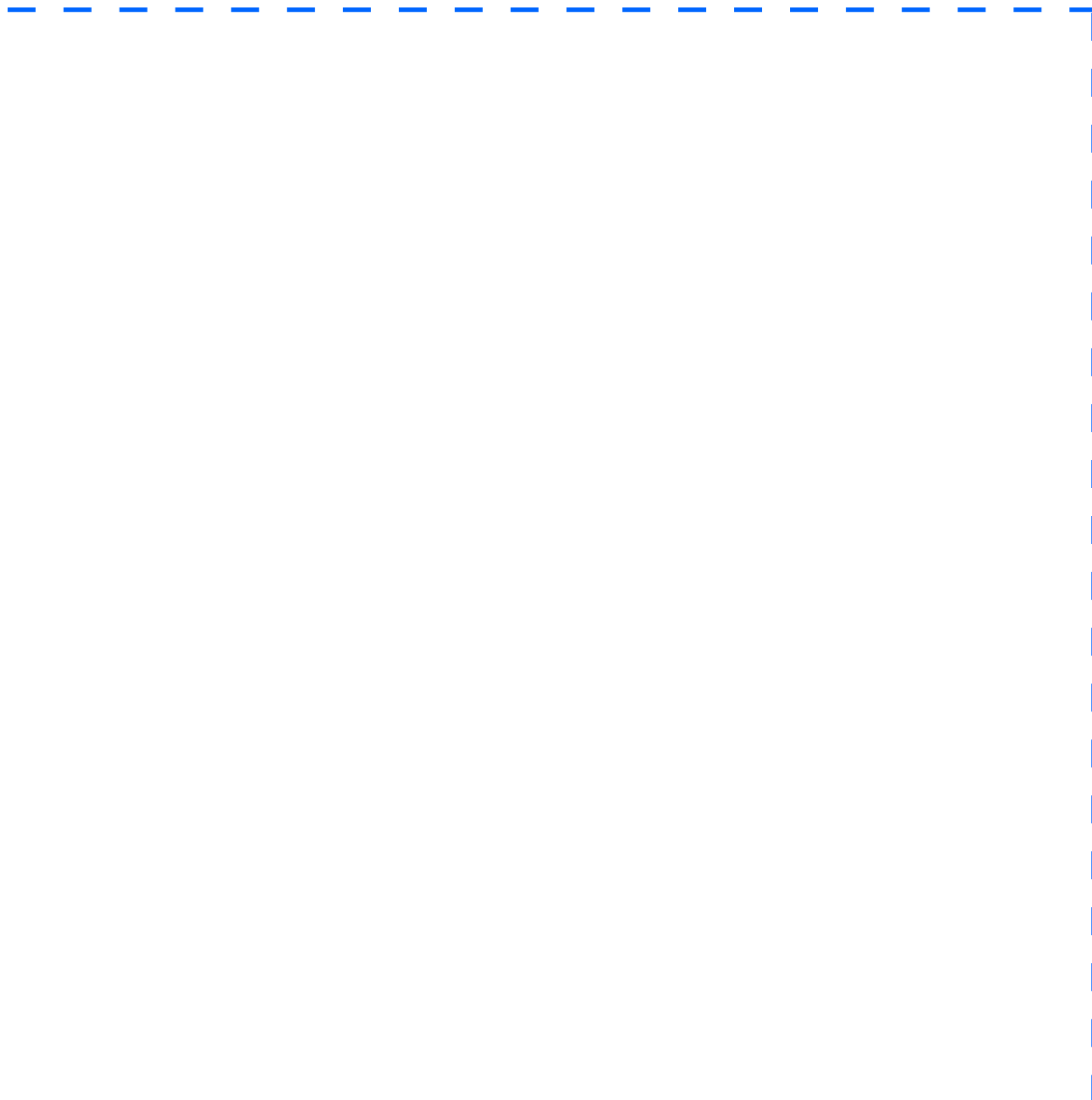


$AE_0$



$GDP_0$

# At Potential GDP

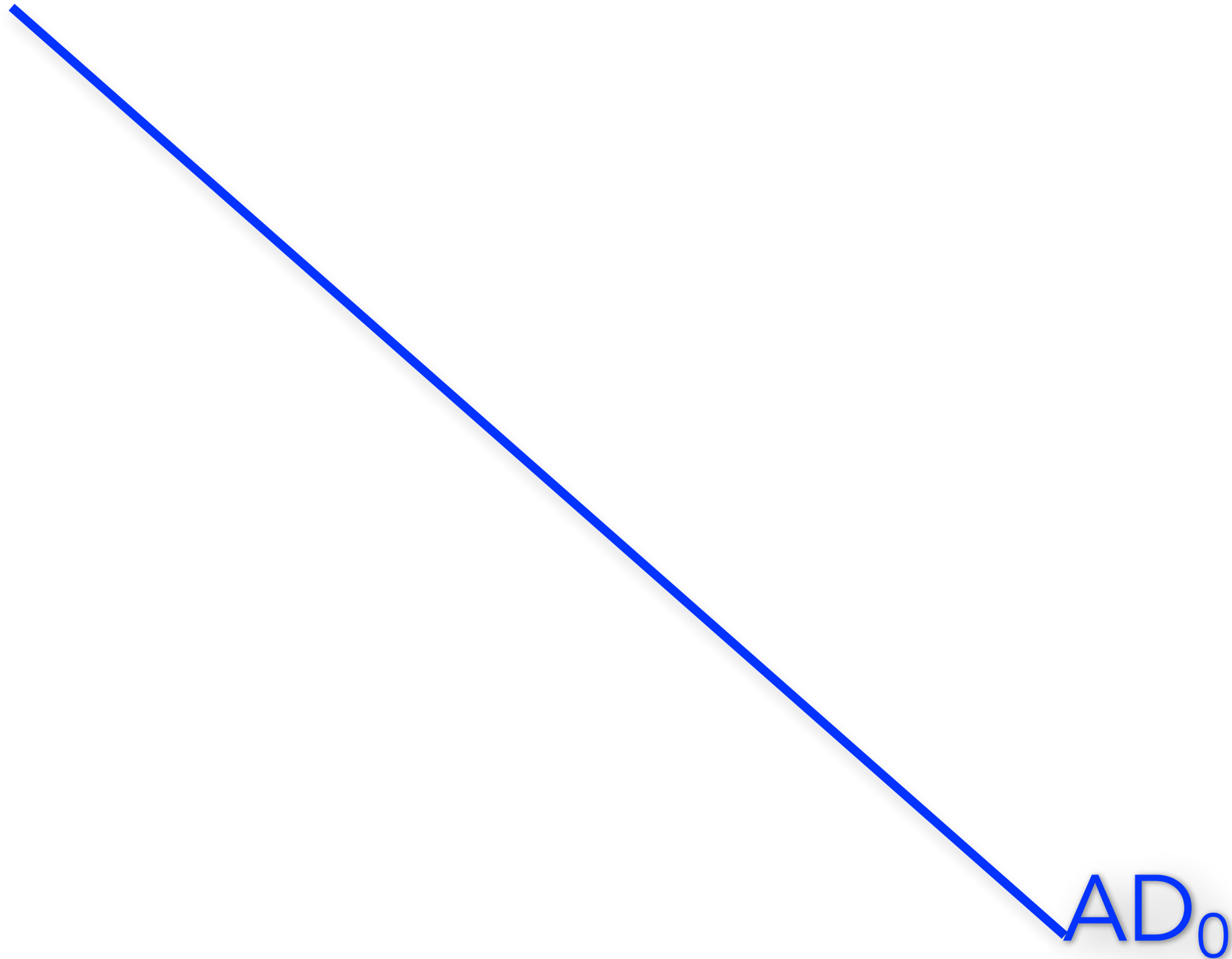


Price Level  
(CPI)









$P_0$

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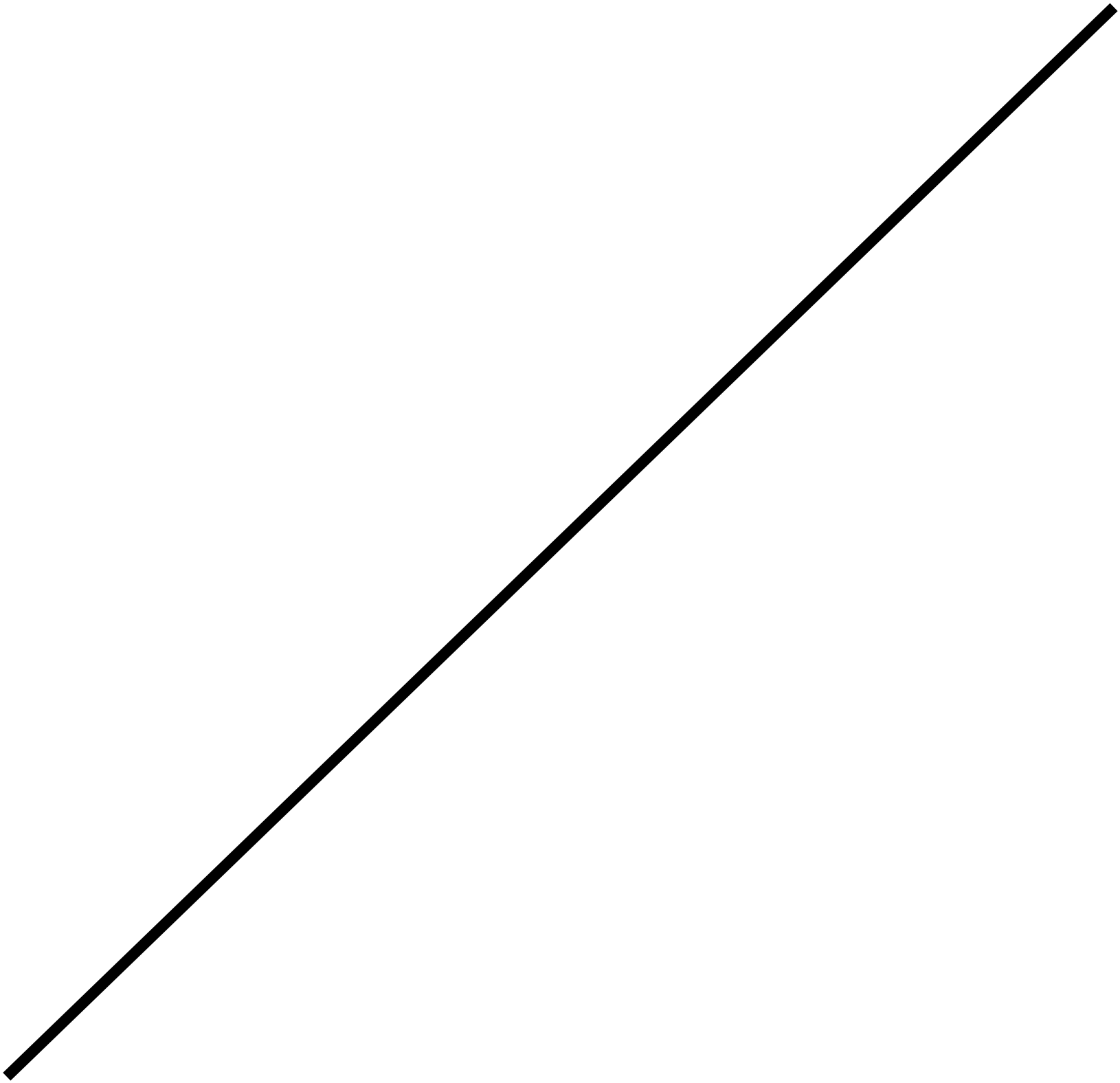
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AS<sub>0</sub>



GDP<sub>0</sub>

At Potential GDP



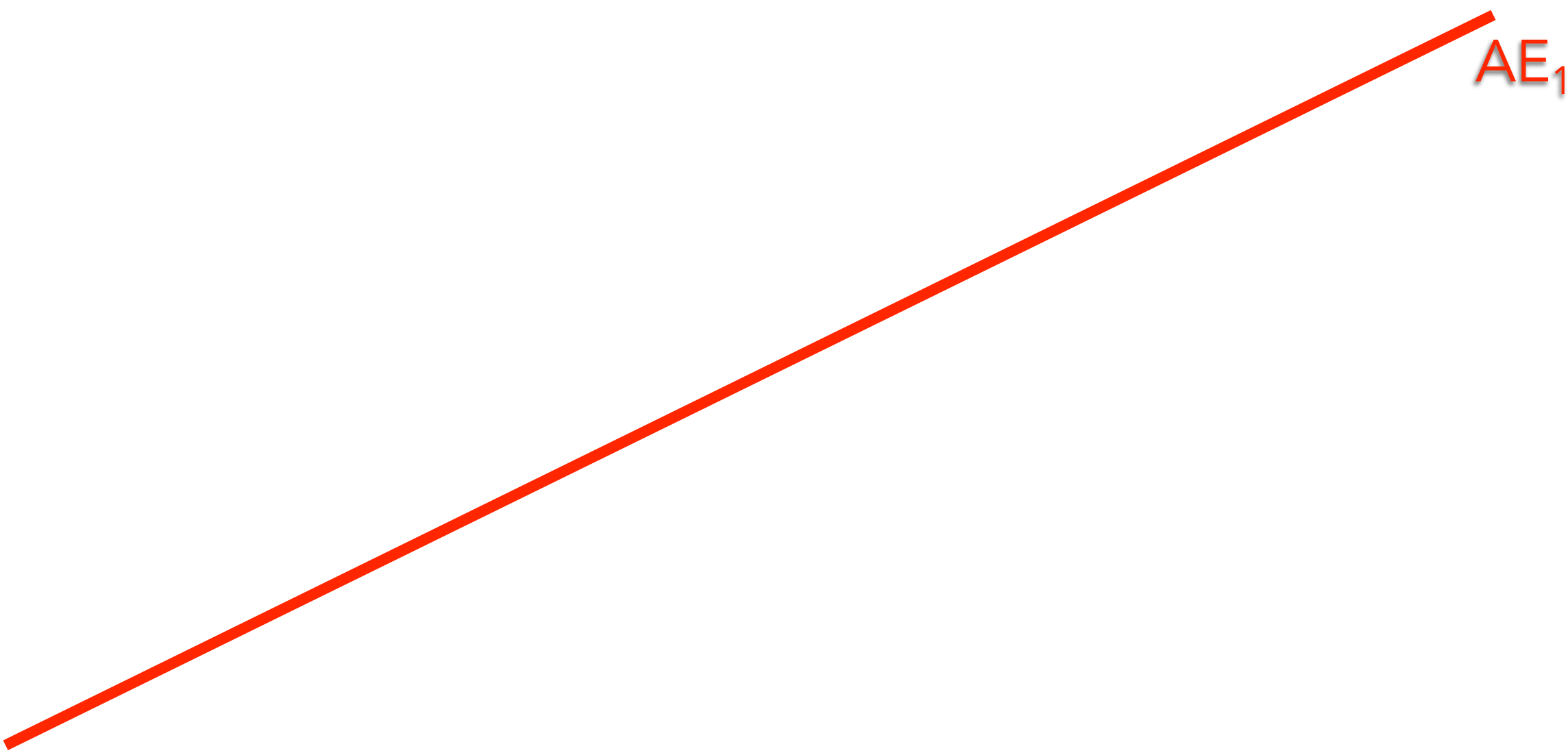
# Inflationary Gap

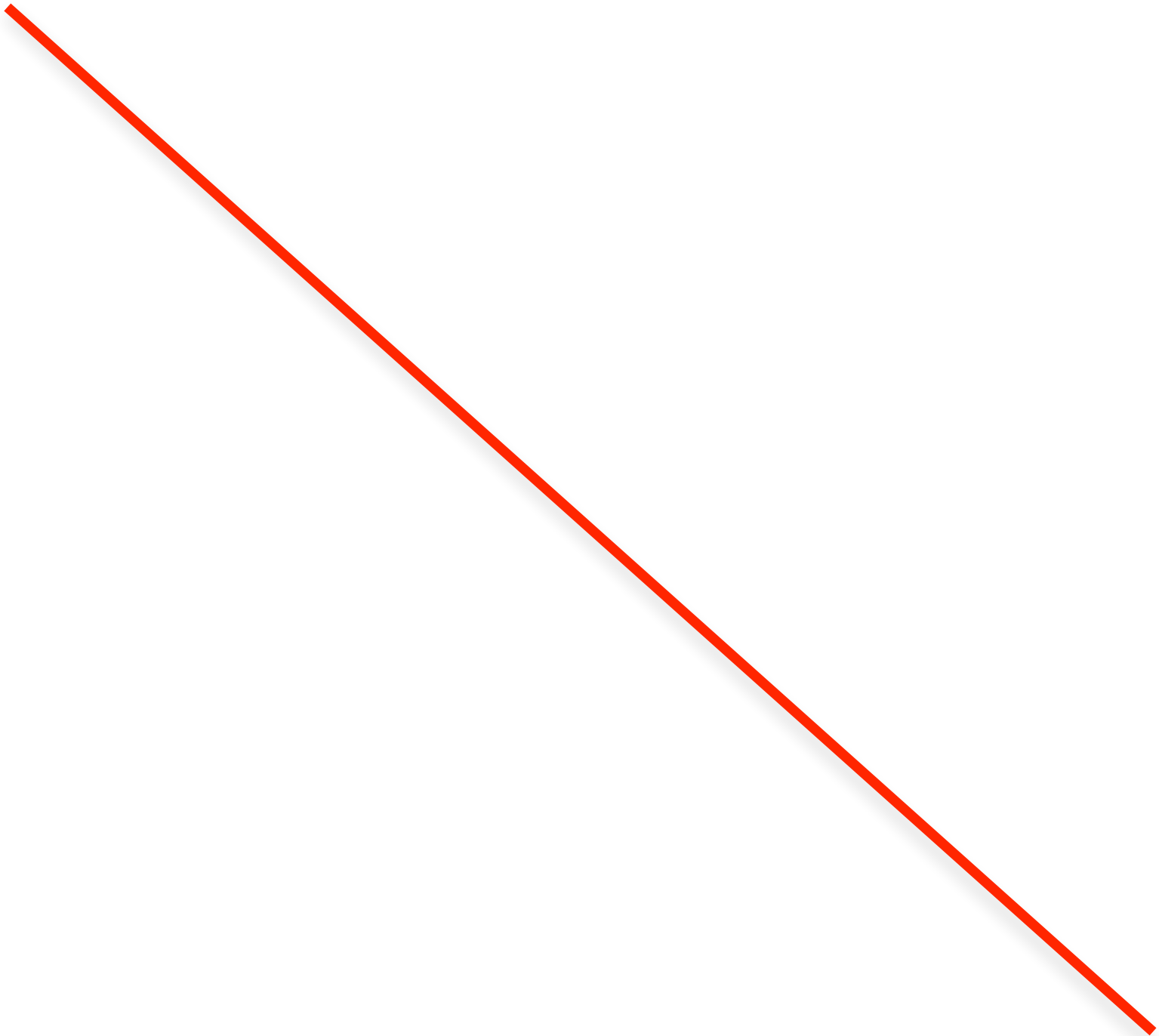




# Inflationary Gap

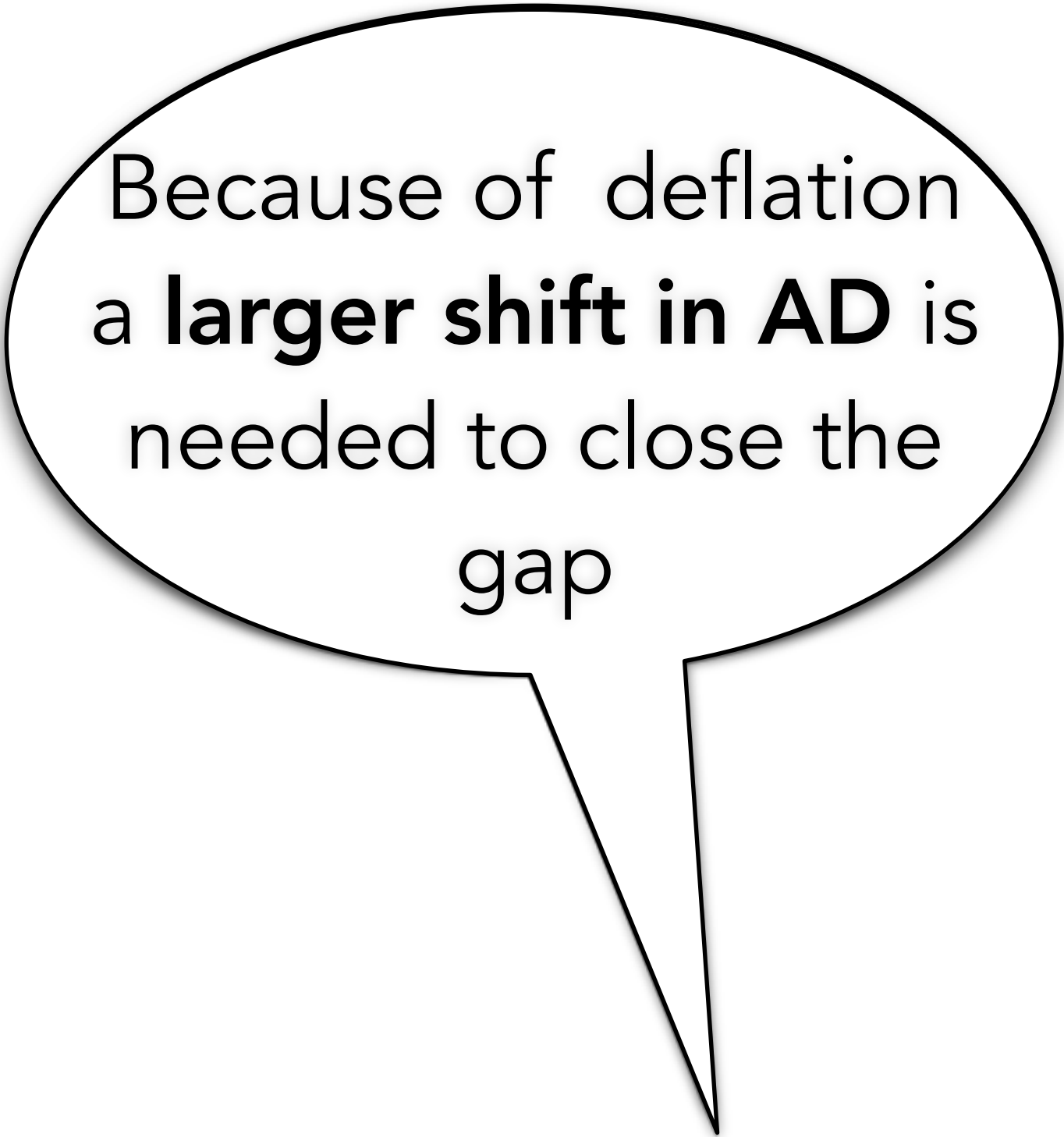




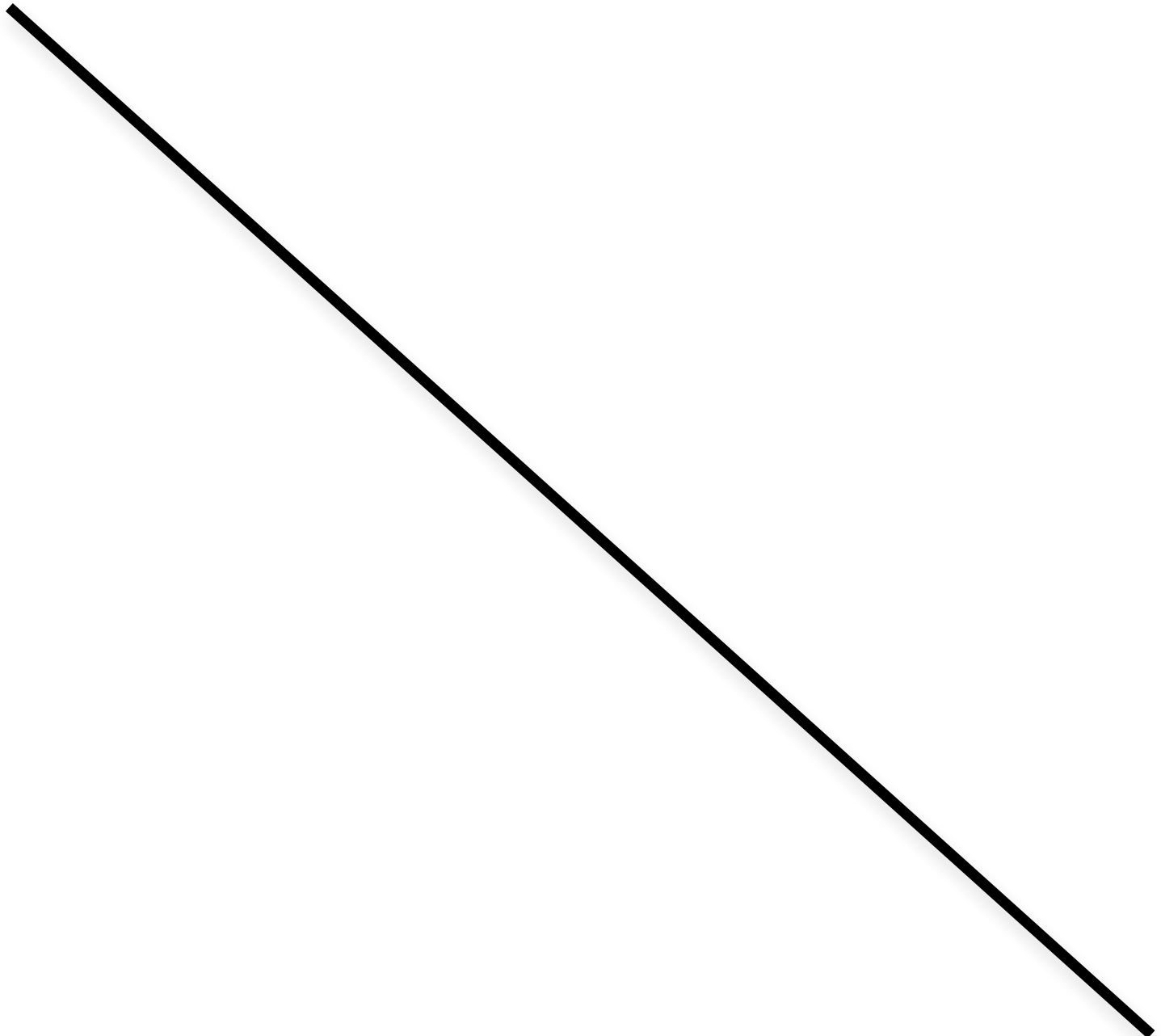


AD<sub>1</sub>

Deflation **reduces** the size of the multiplier



Because of deflation  
a **larger shift in AD** is  
needed to close the  
gap



AD<sub>1</sub>



$P_1$

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GDP<sub>1</sub>

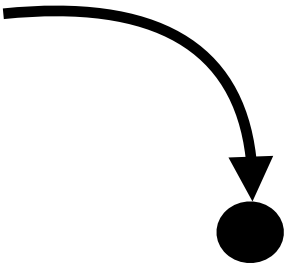
$P_2$

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GDP<sub>2</sub>

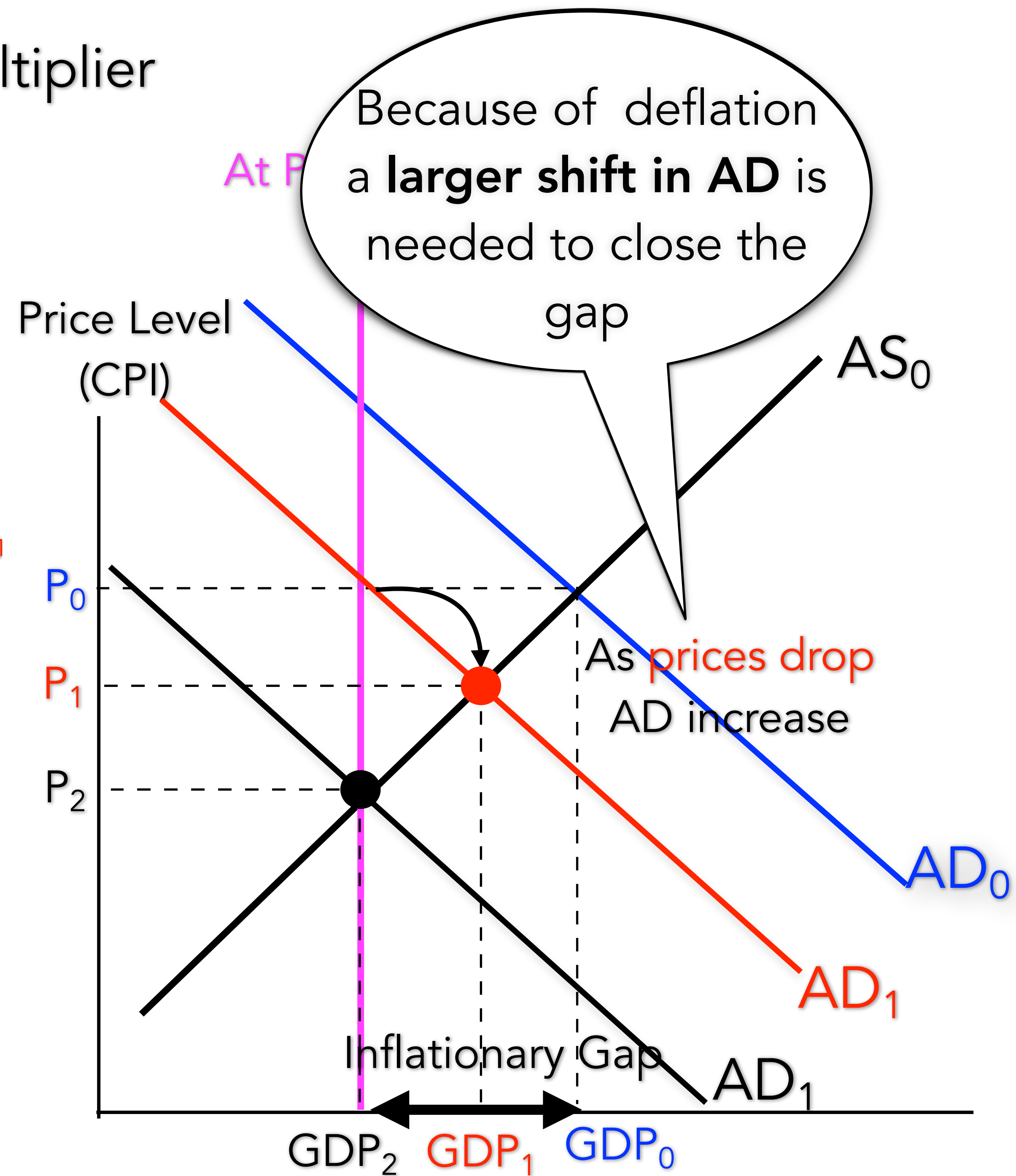
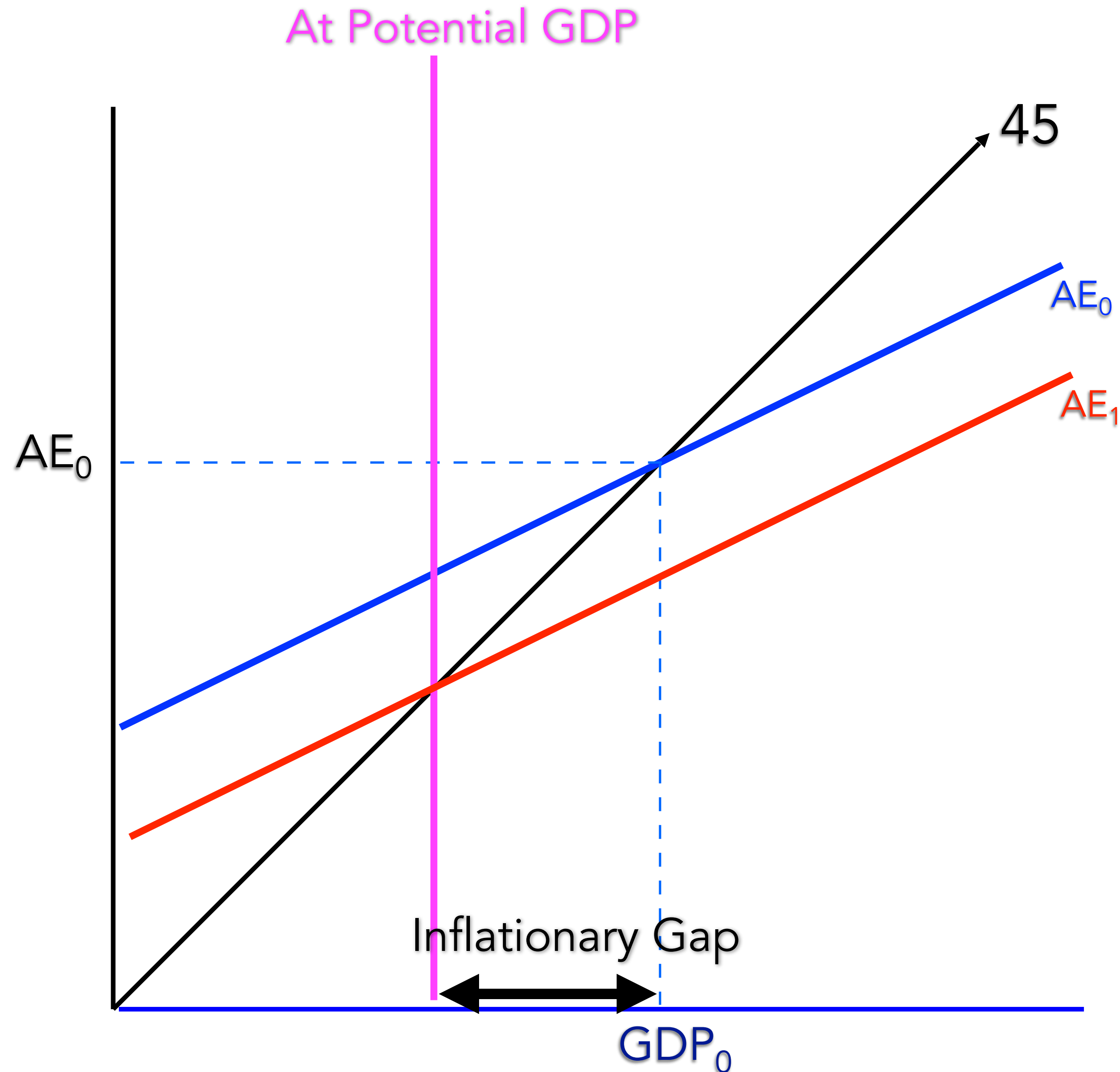




As prices drop  
AD increase



Deflation **reduces** the size of the multiplier





# The Effect of an Increase in Supply

