

$AE_0$

$GDP_0$

# Potential GDP

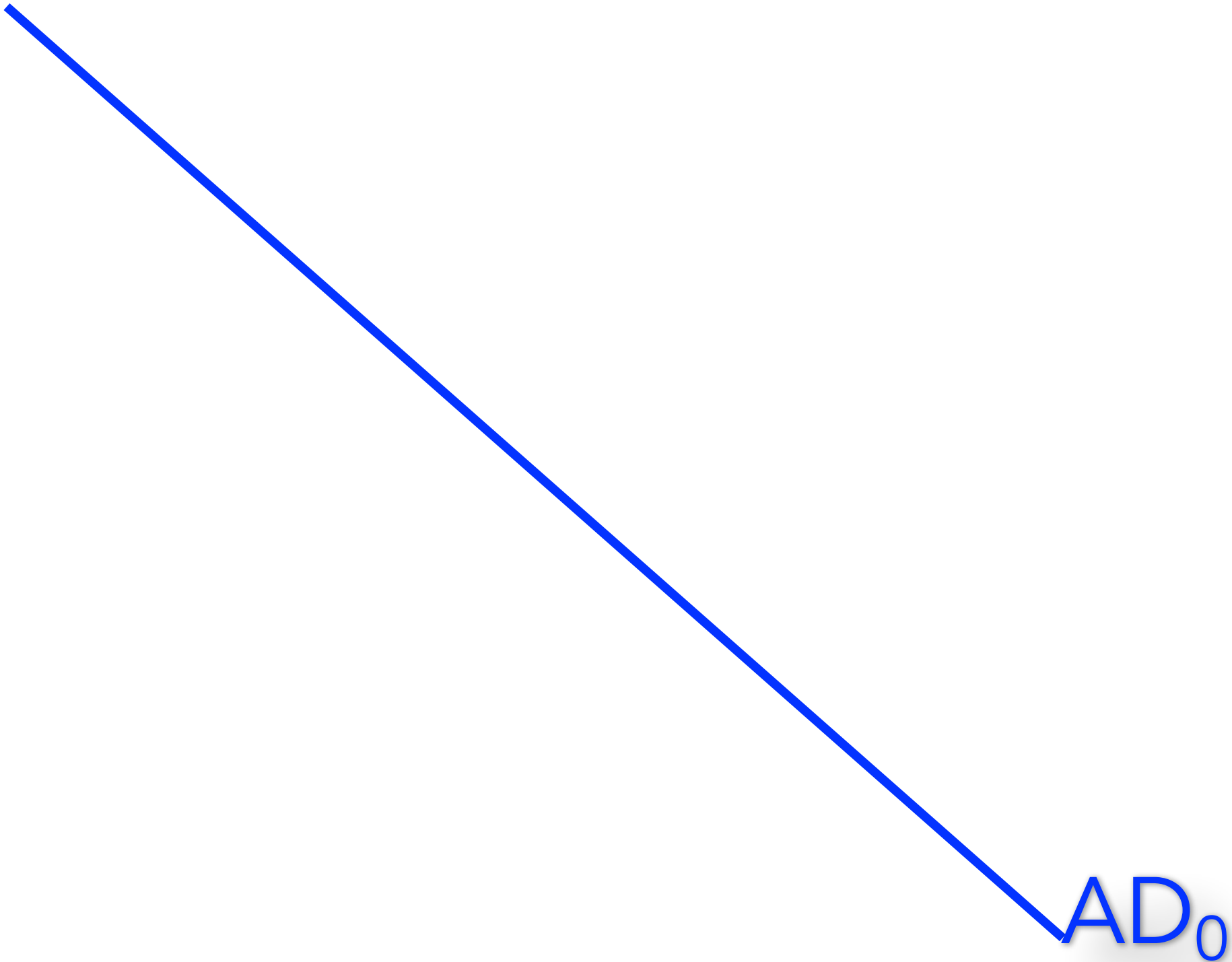


Price Level  
(CPI)









$P_0$

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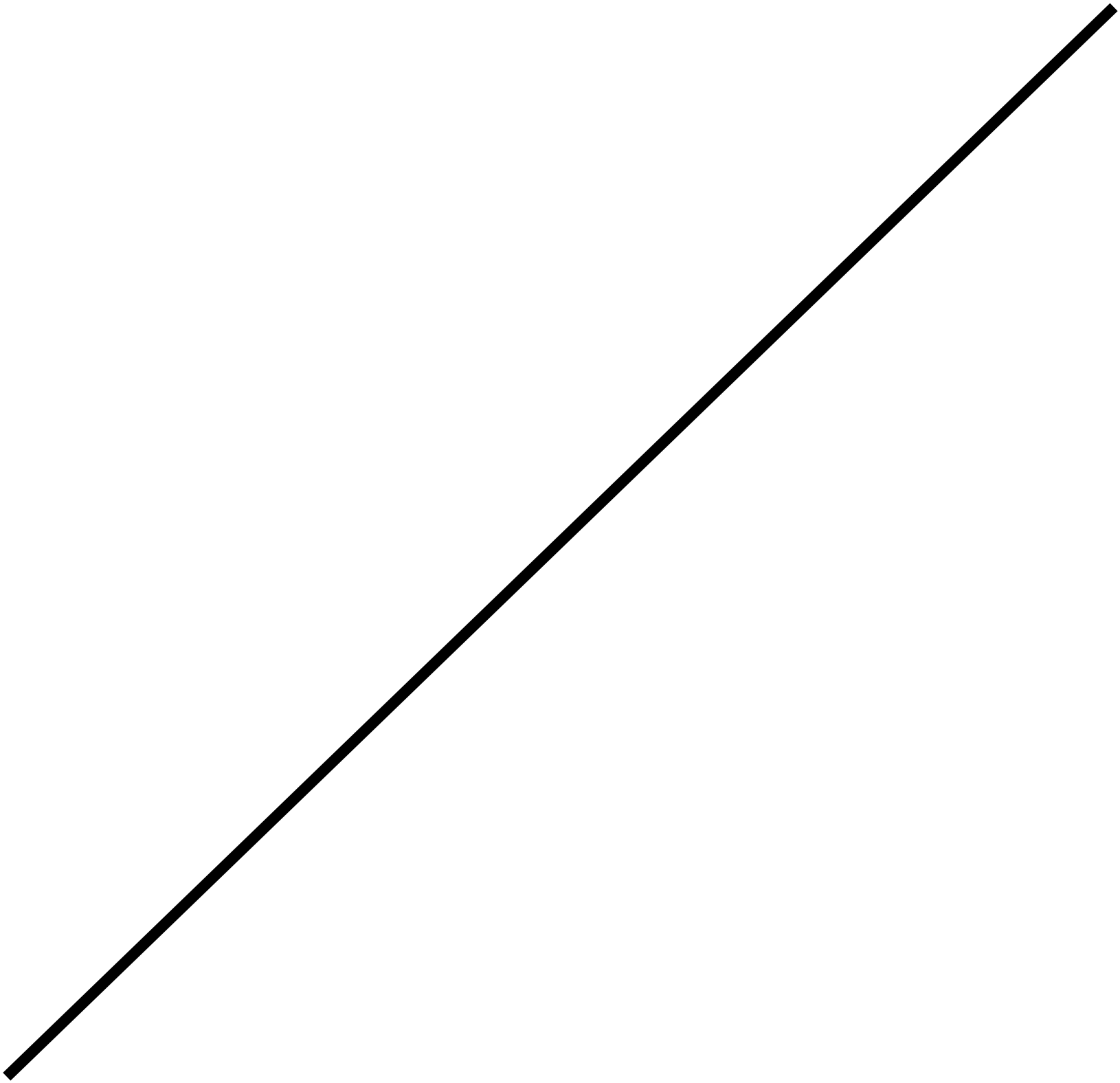
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AS<sub>0</sub>



GDP<sub>0</sub>

# Potential GDP



# Inflationary Gap



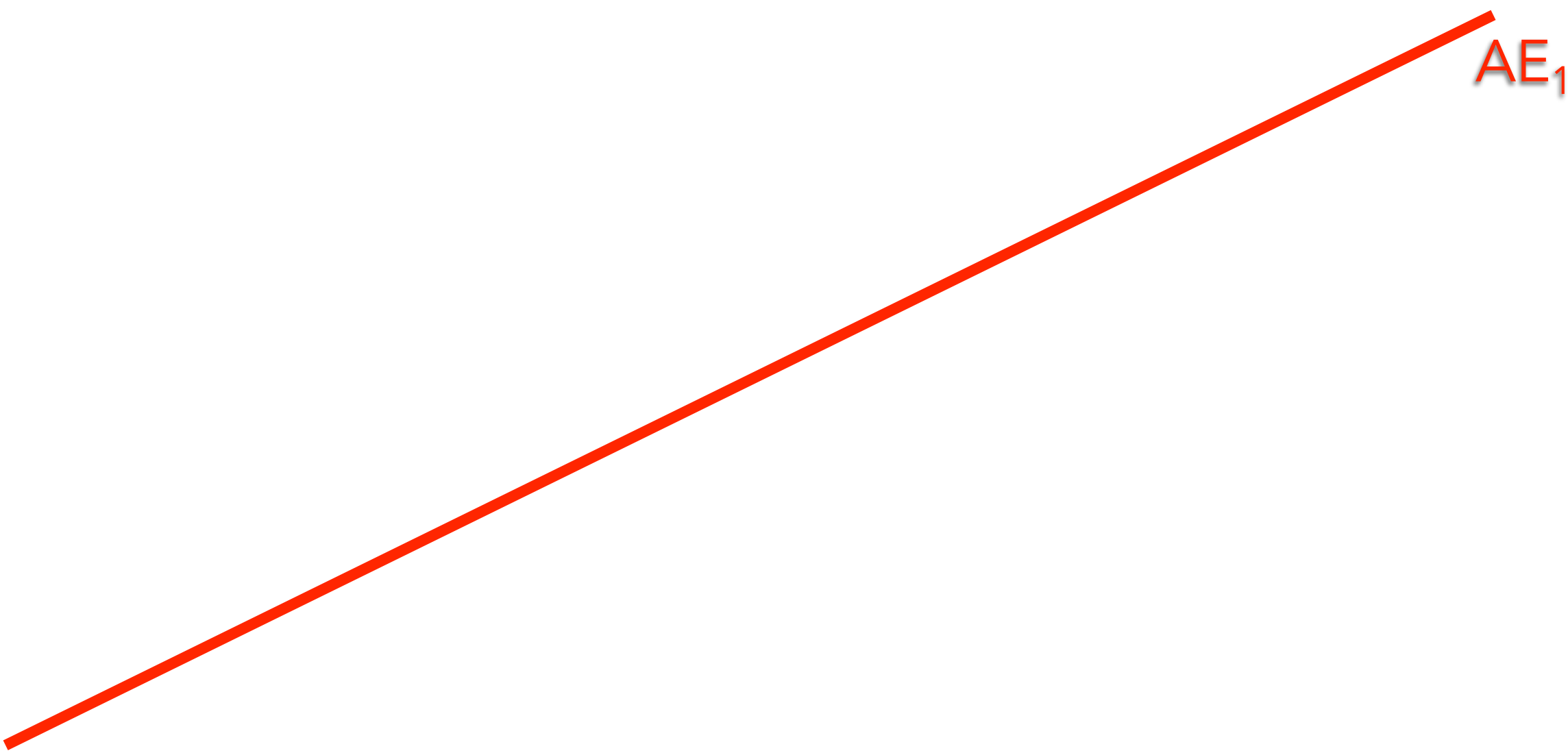


# Inflationary Gap



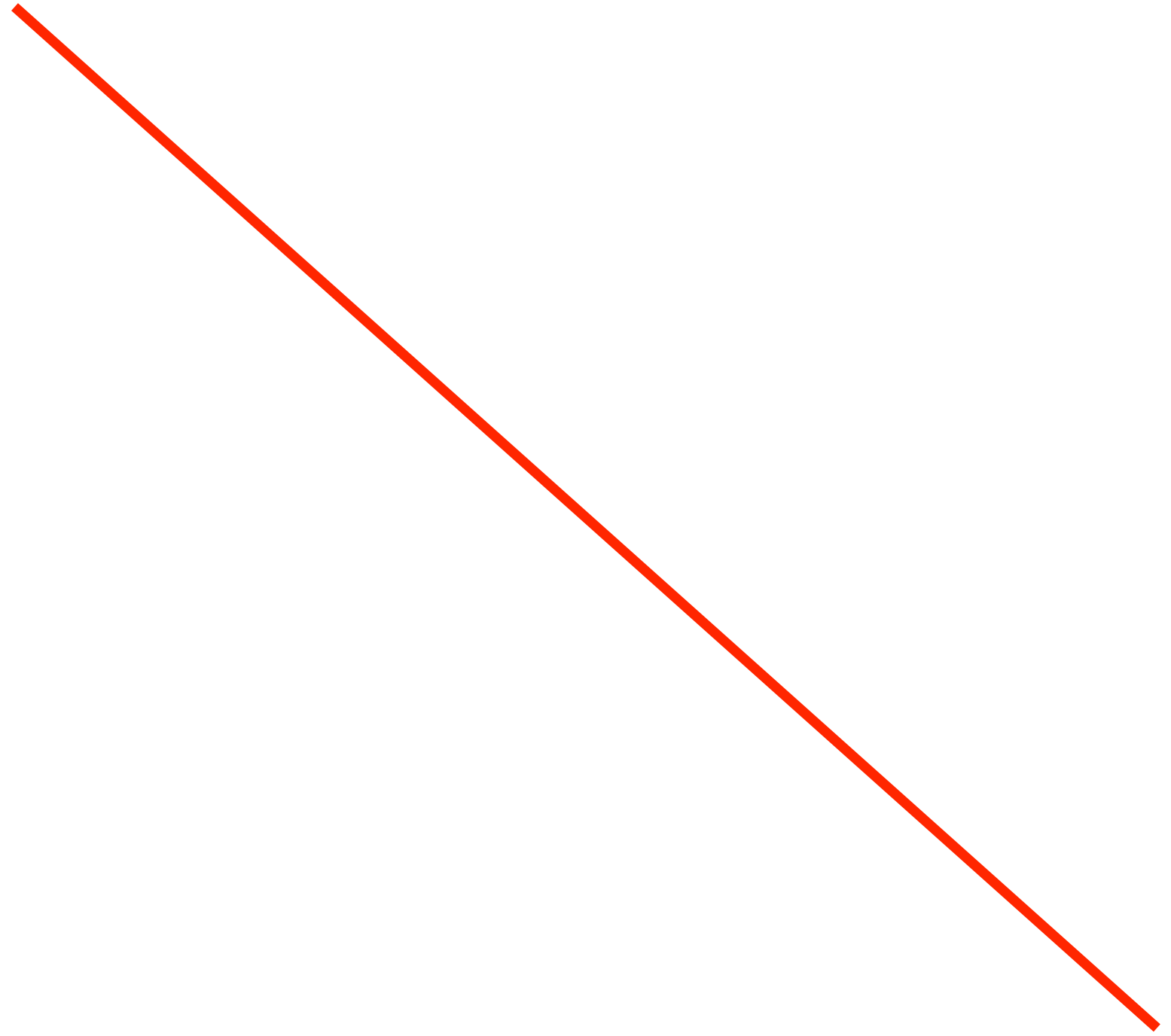
To close an Inflationary Gap, Aggregate Expenditures and Aggregate

Demand must decrease



Decrease in AD

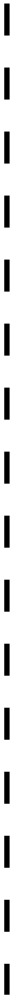




AD<sub>1</sub>

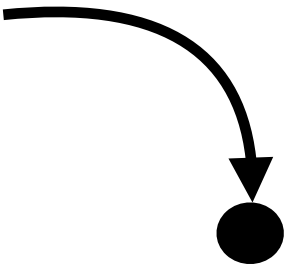
P<sub>1</sub>





GDP<sub>1</sub>





As prices drop  
AD increase

As prices drop, AD  
increase offsetting the  
impact of contractionary  
Policy on Demand

To close an **Inflationary** Gap, Aggregate Expenditures and Aggregate Demand must **decrease**

