

AE_0

GDP_0

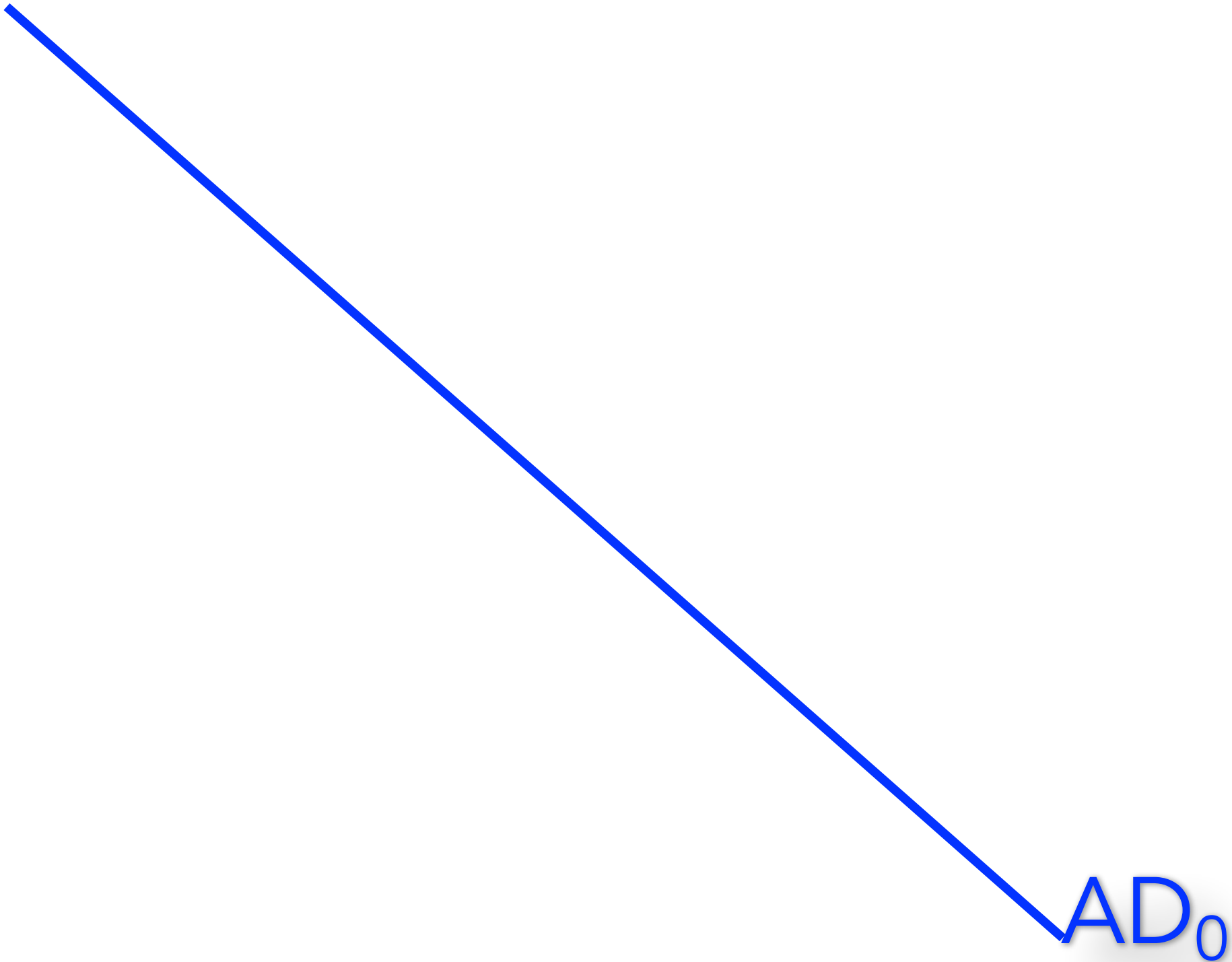
Potential GDP



Price Level
(CPI)







P_0

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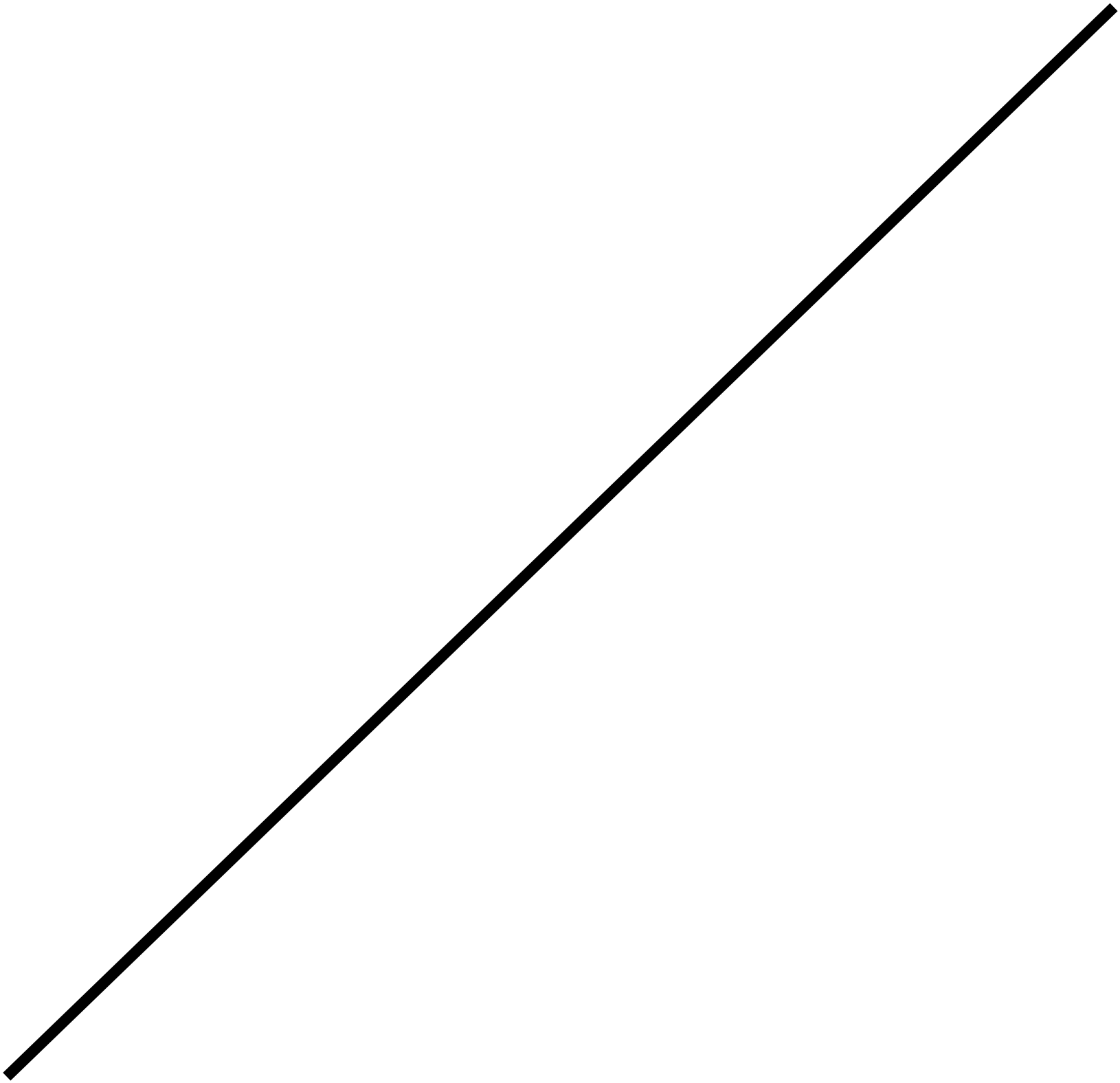
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AS₀



GDP₀

Potential GDP



Inflationary Gap

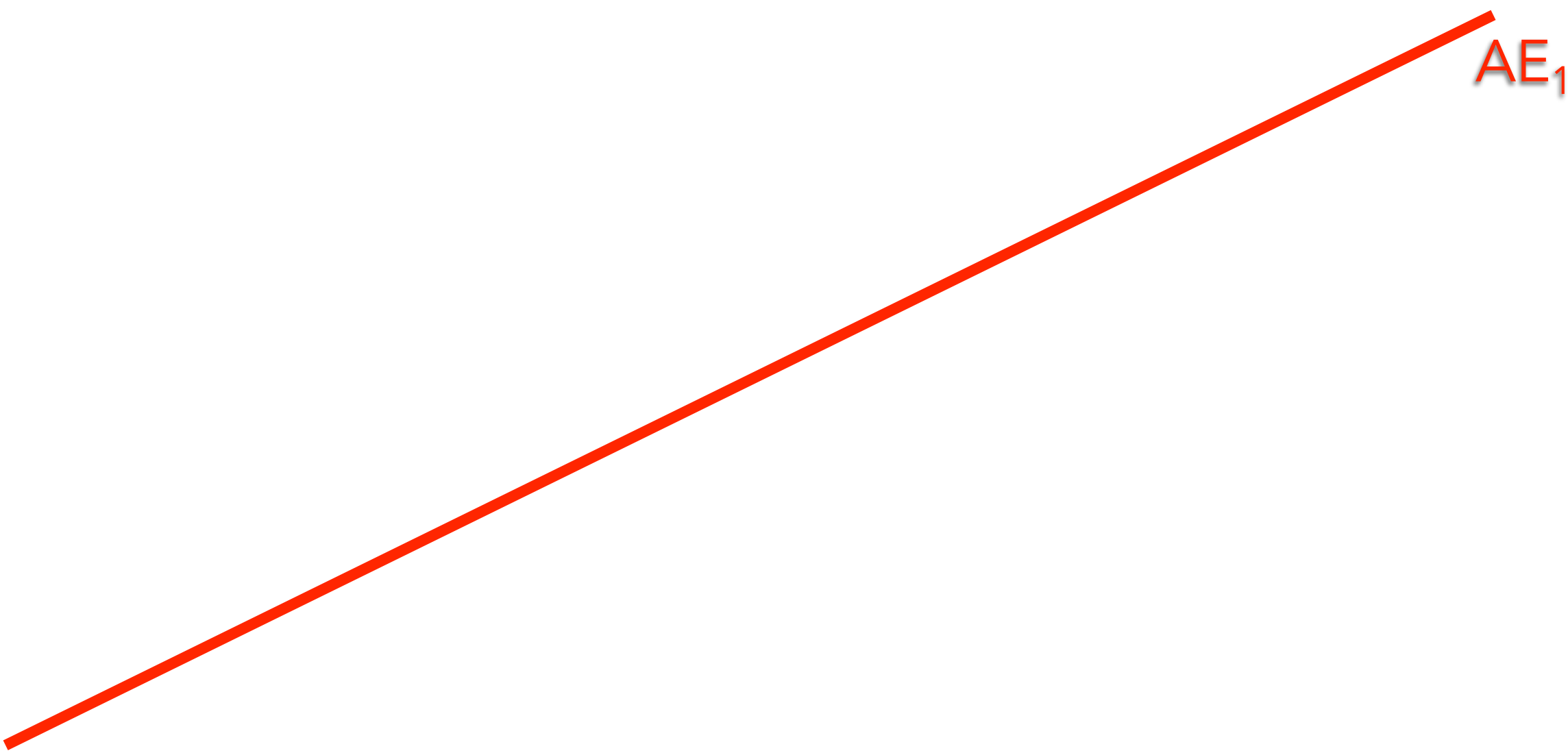


Inflationary Gap



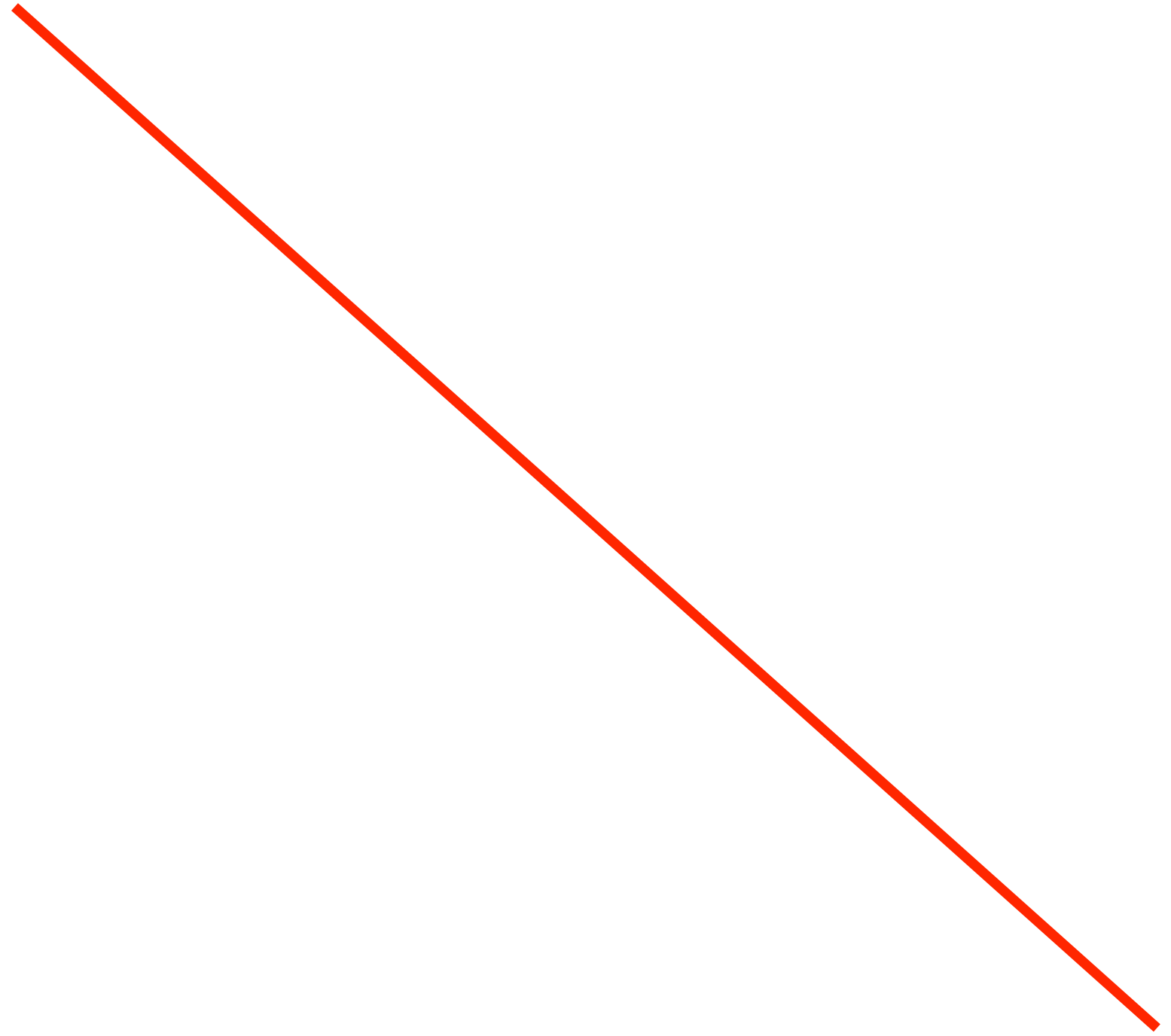
To close an Inflationary Gap, Aggregate Expenditures and Aggregate

Demand must decrease



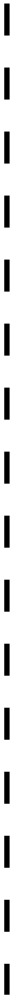
Decrease in AD



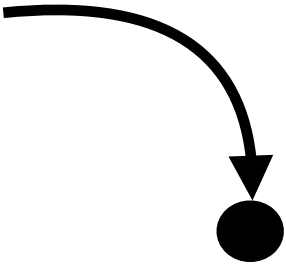


AD₁

P_1



GDP₁



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**

