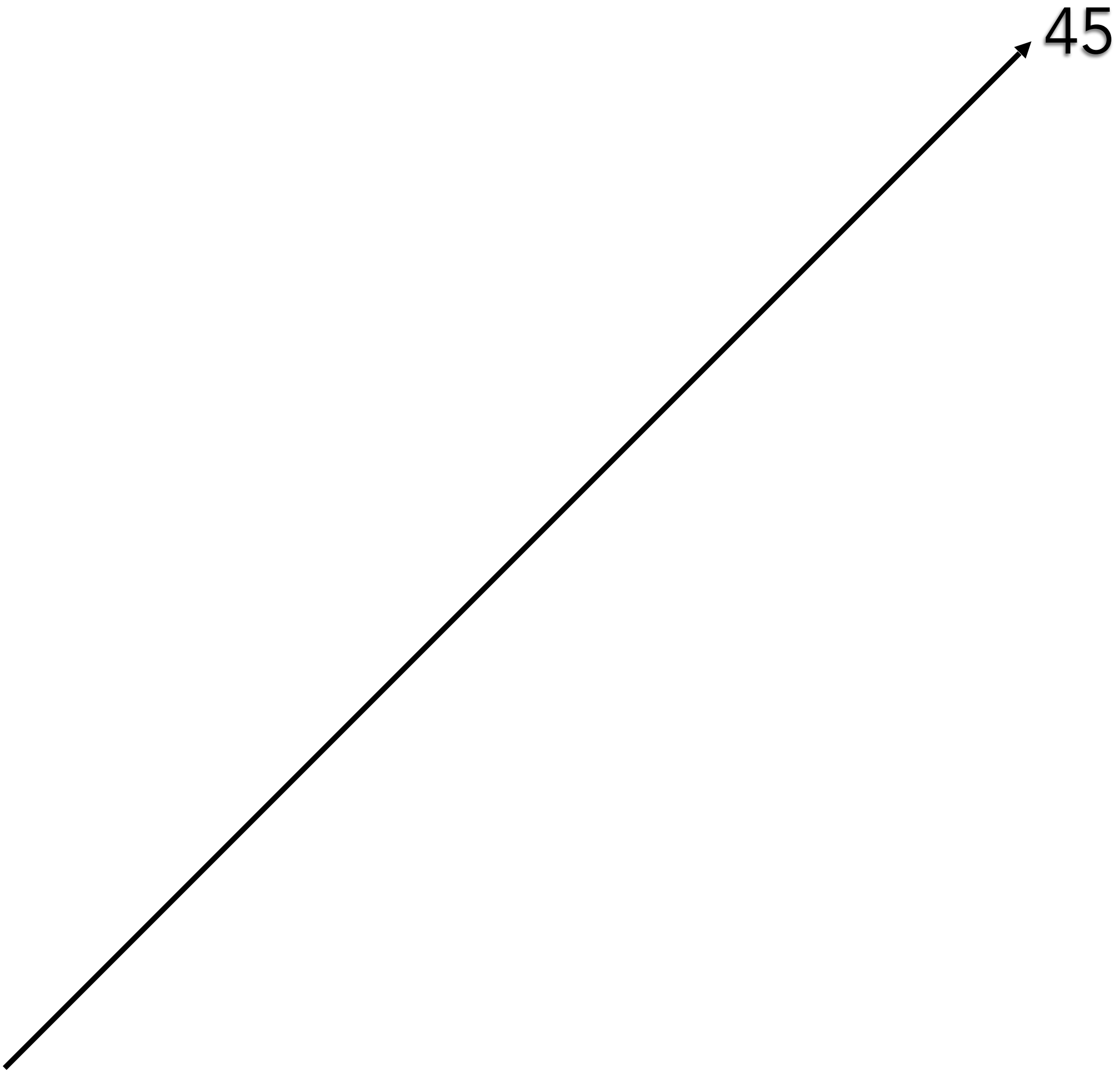
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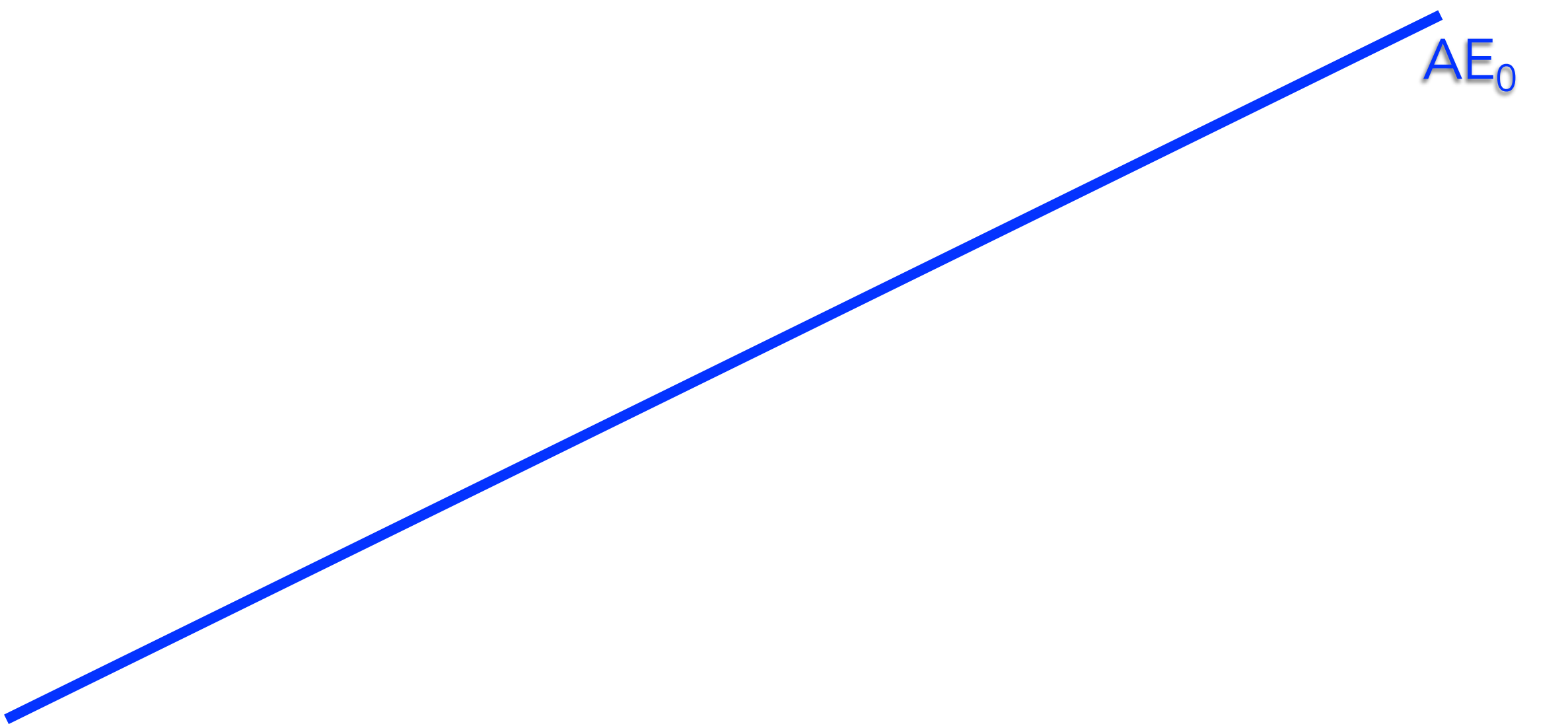
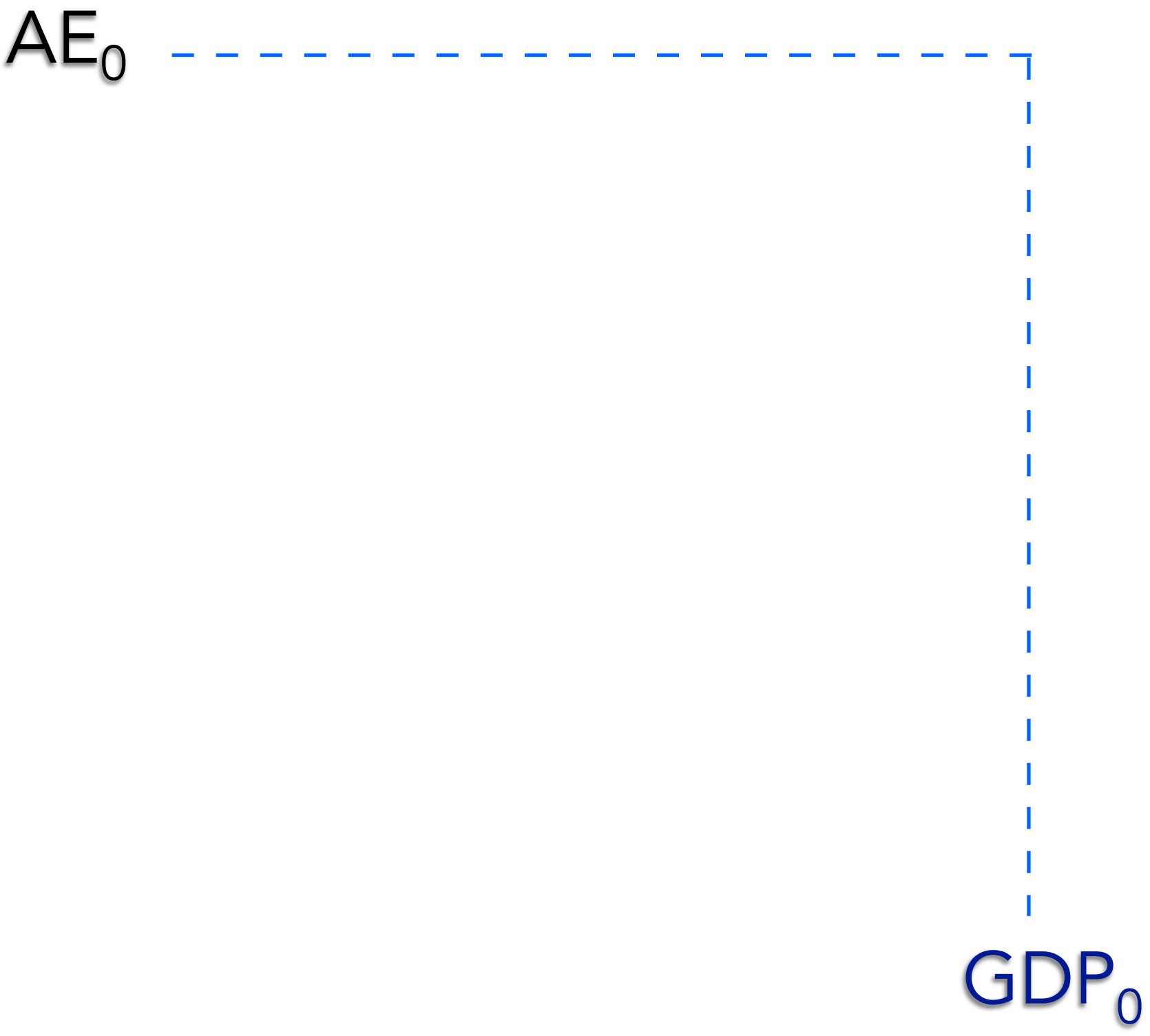
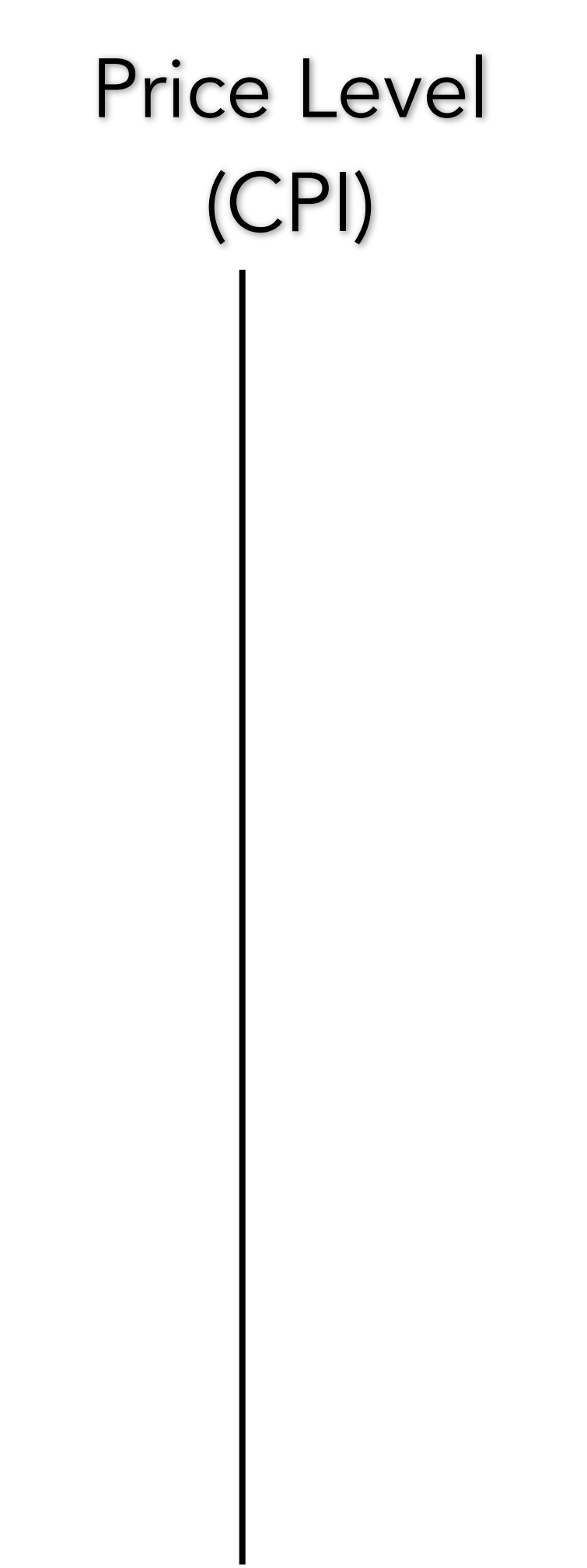
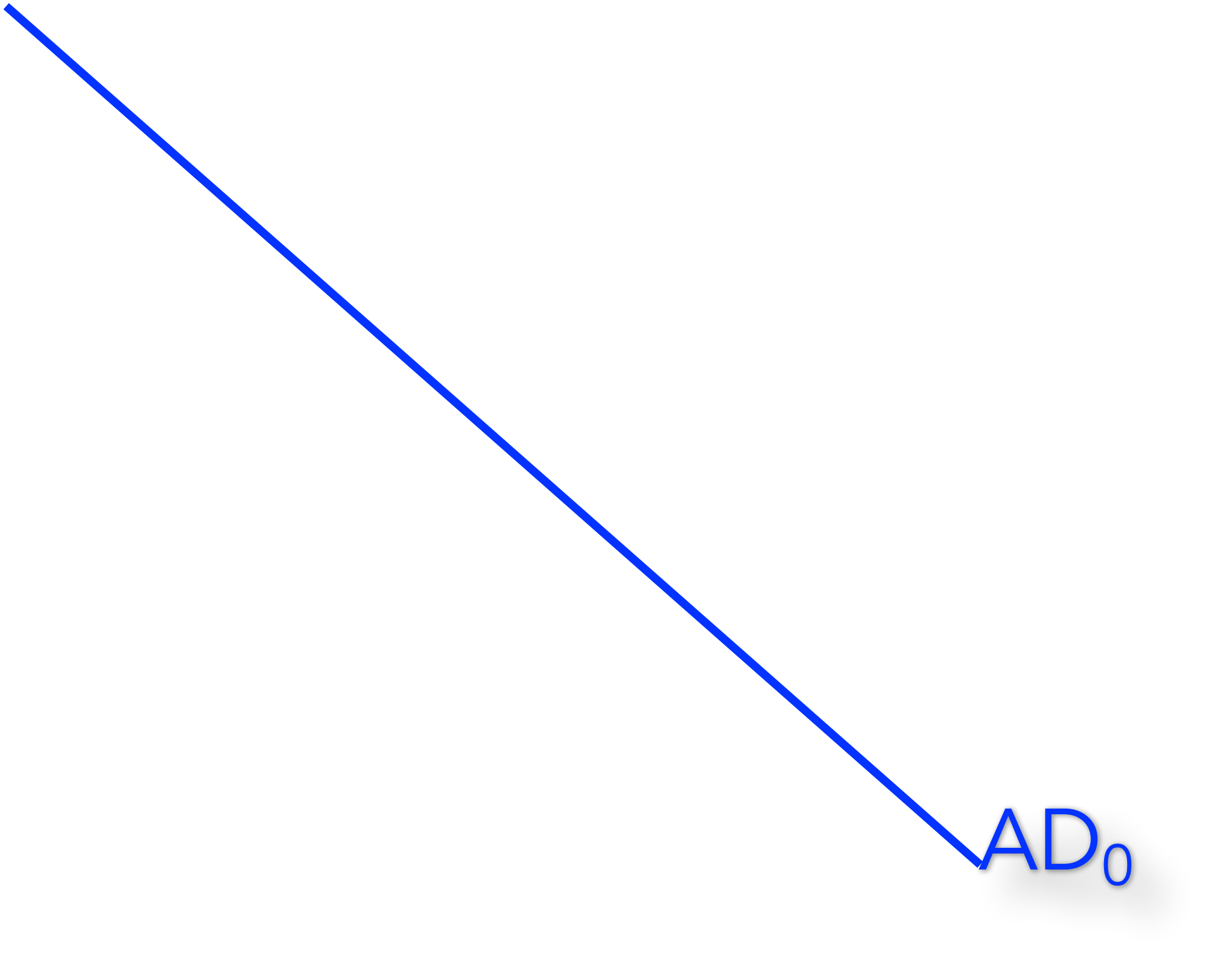

AE_0


AE_0
GDP_0

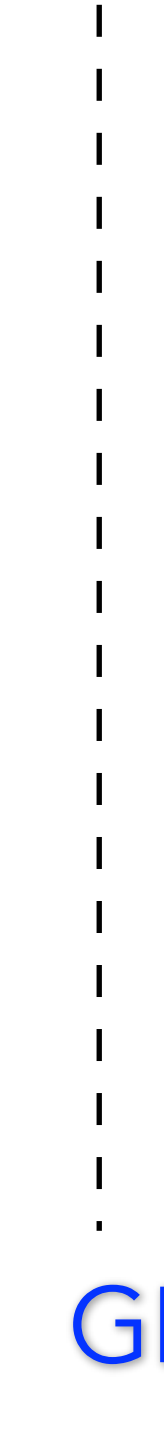
Potential GDP


Price Level
(CPI)


AD_0

P_0

AS_0


GDP_0

Potential GDP

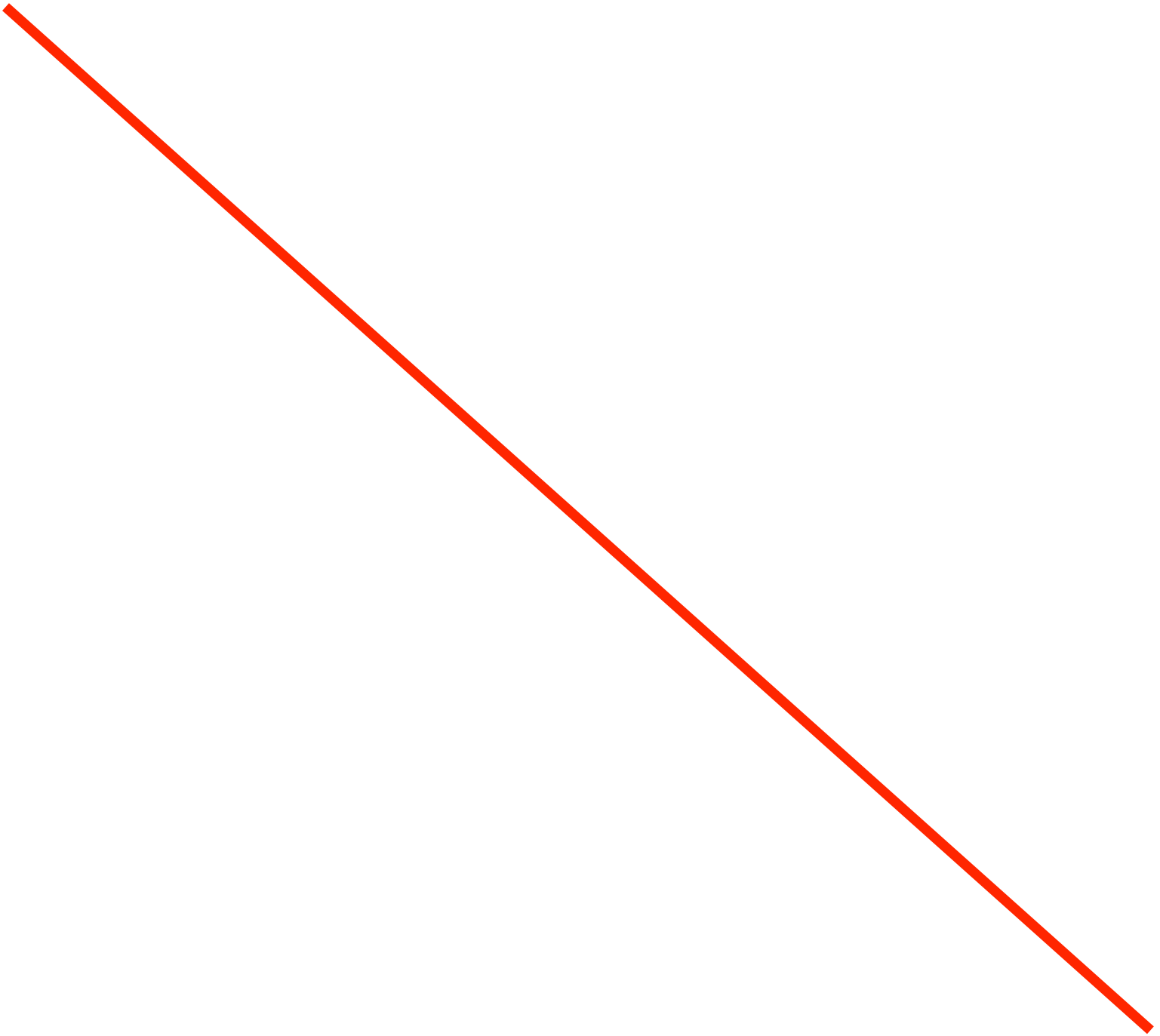
Inflationary Gap

Inflationary Gap

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

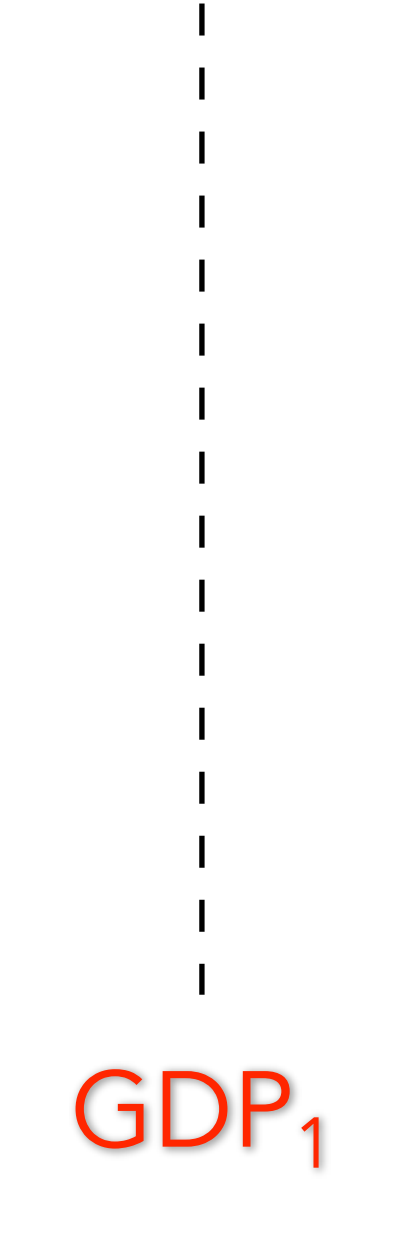
AE_1

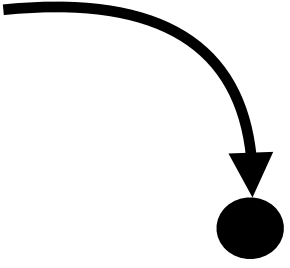
Decrease in AD



AD1

P1

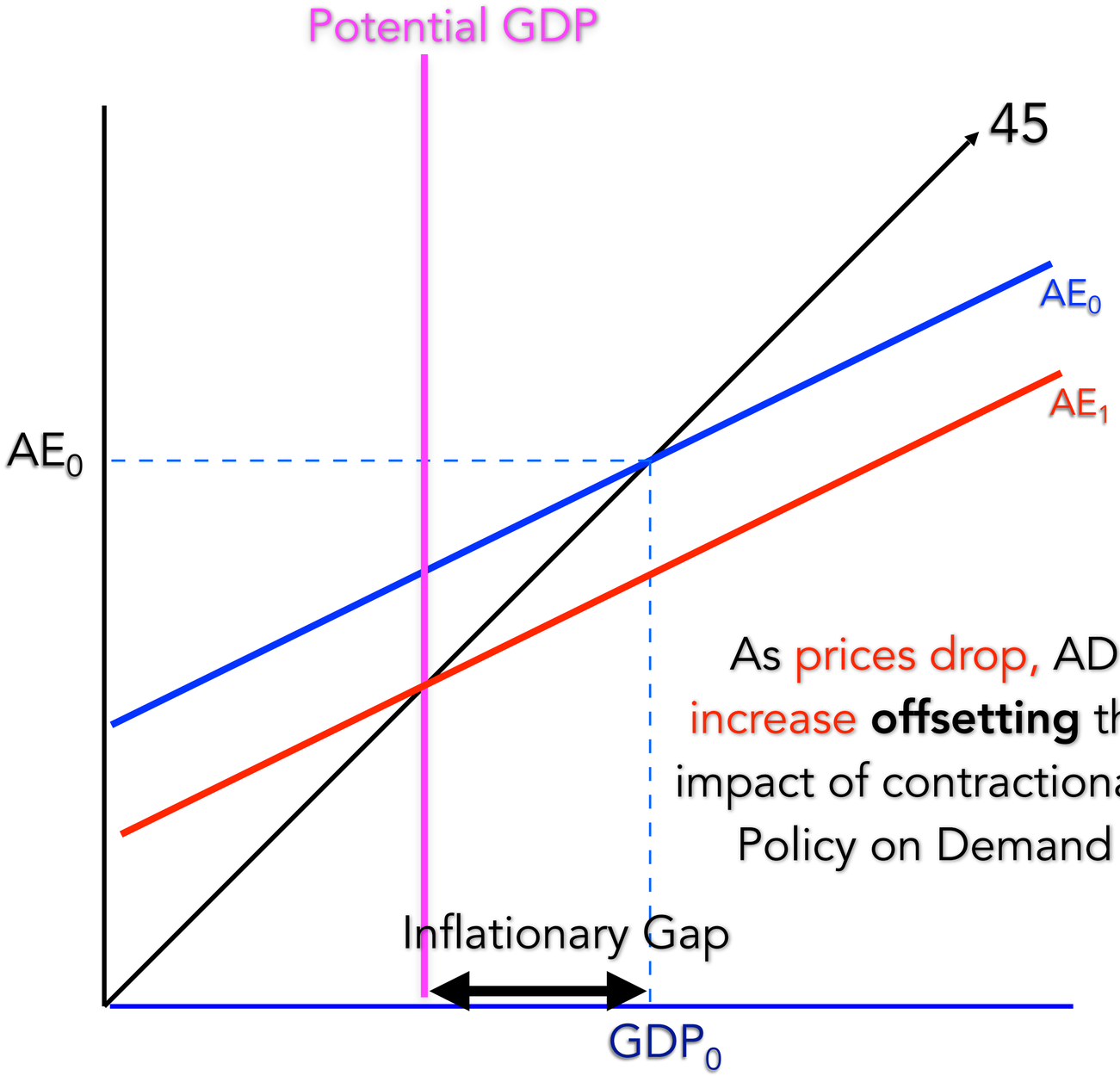

GDP_1



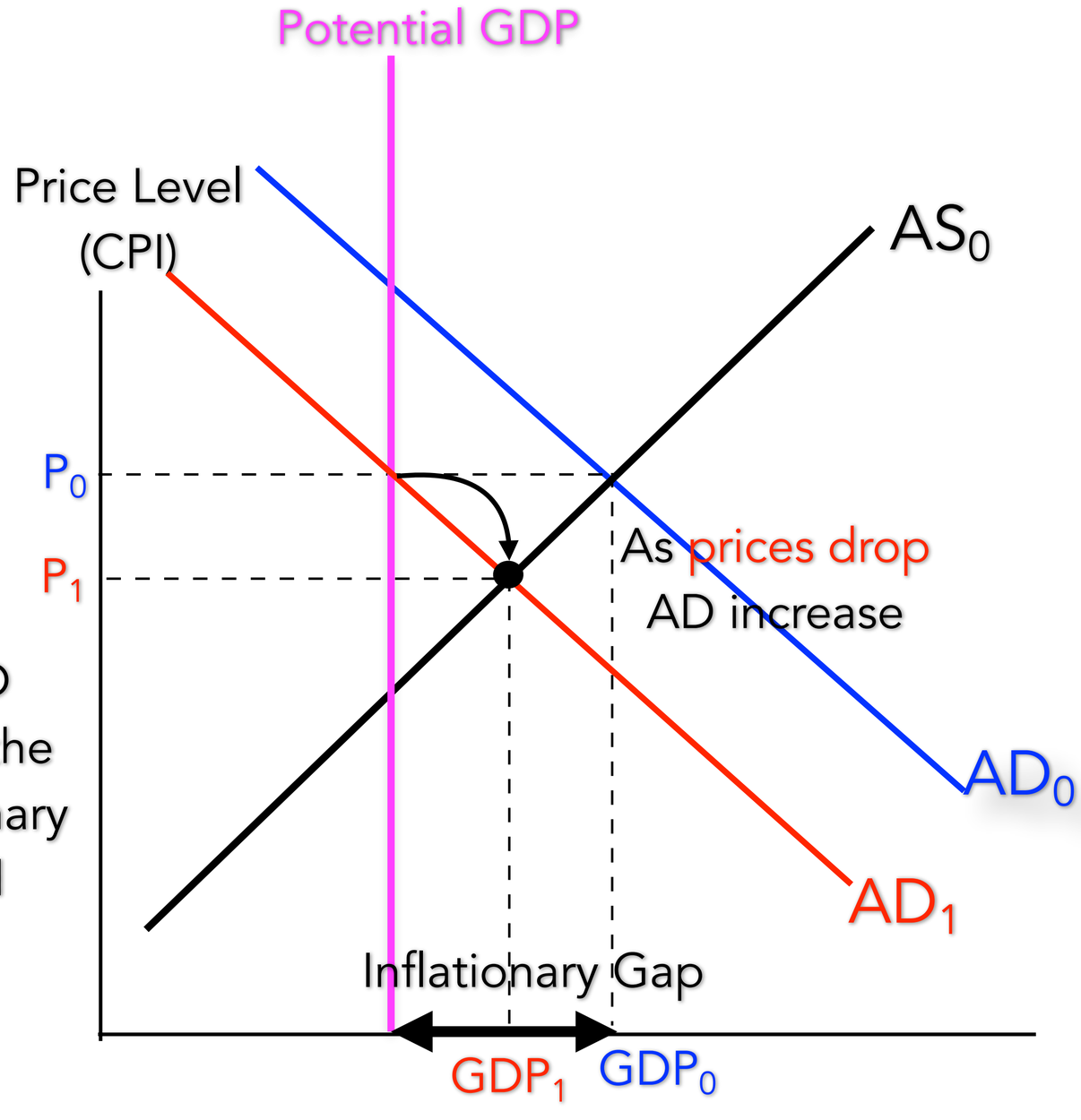
As prices drop
AD increase

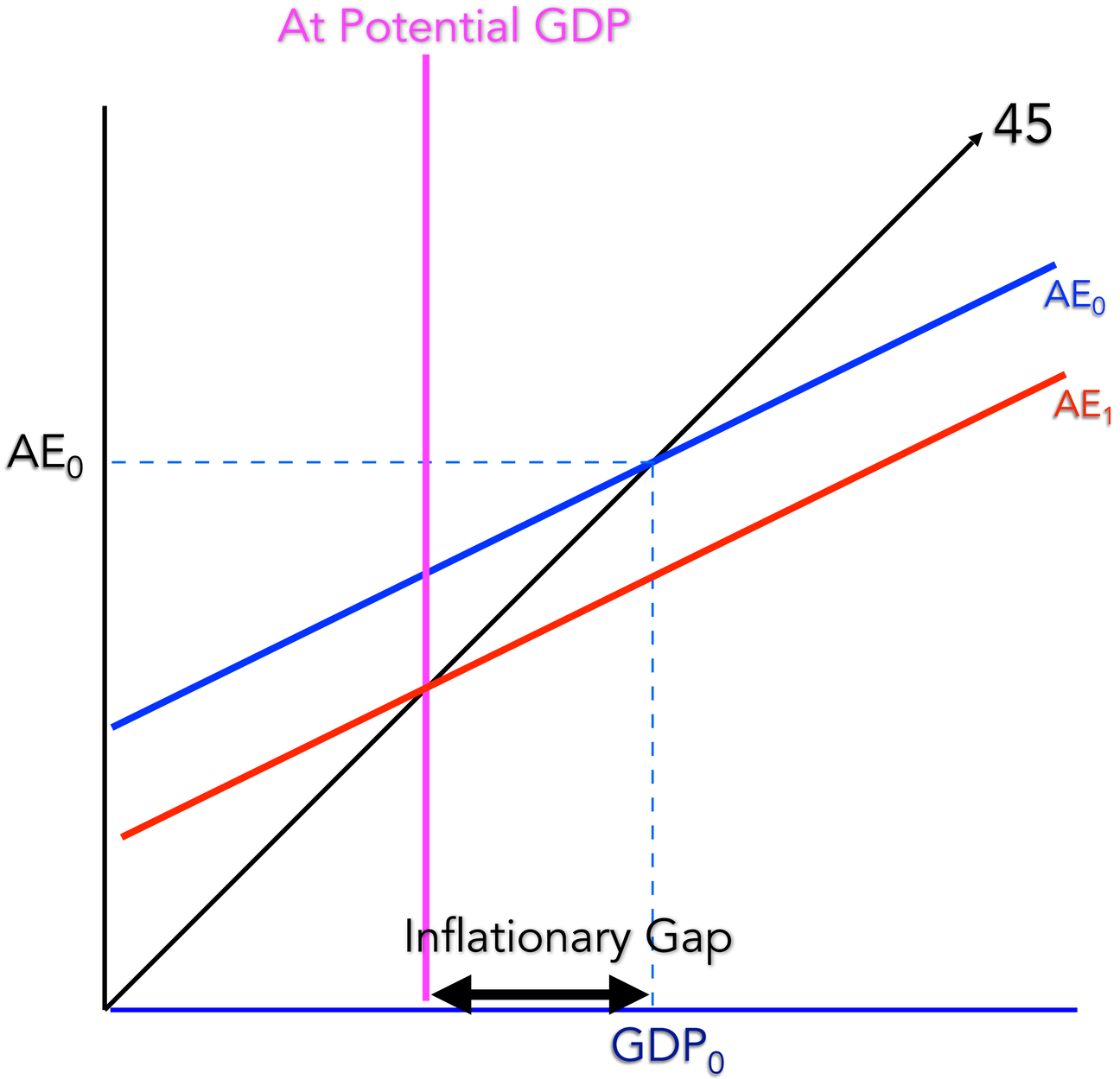
As prices drop, AD increase **offsetting** the impact of contractionary Policy on Demand

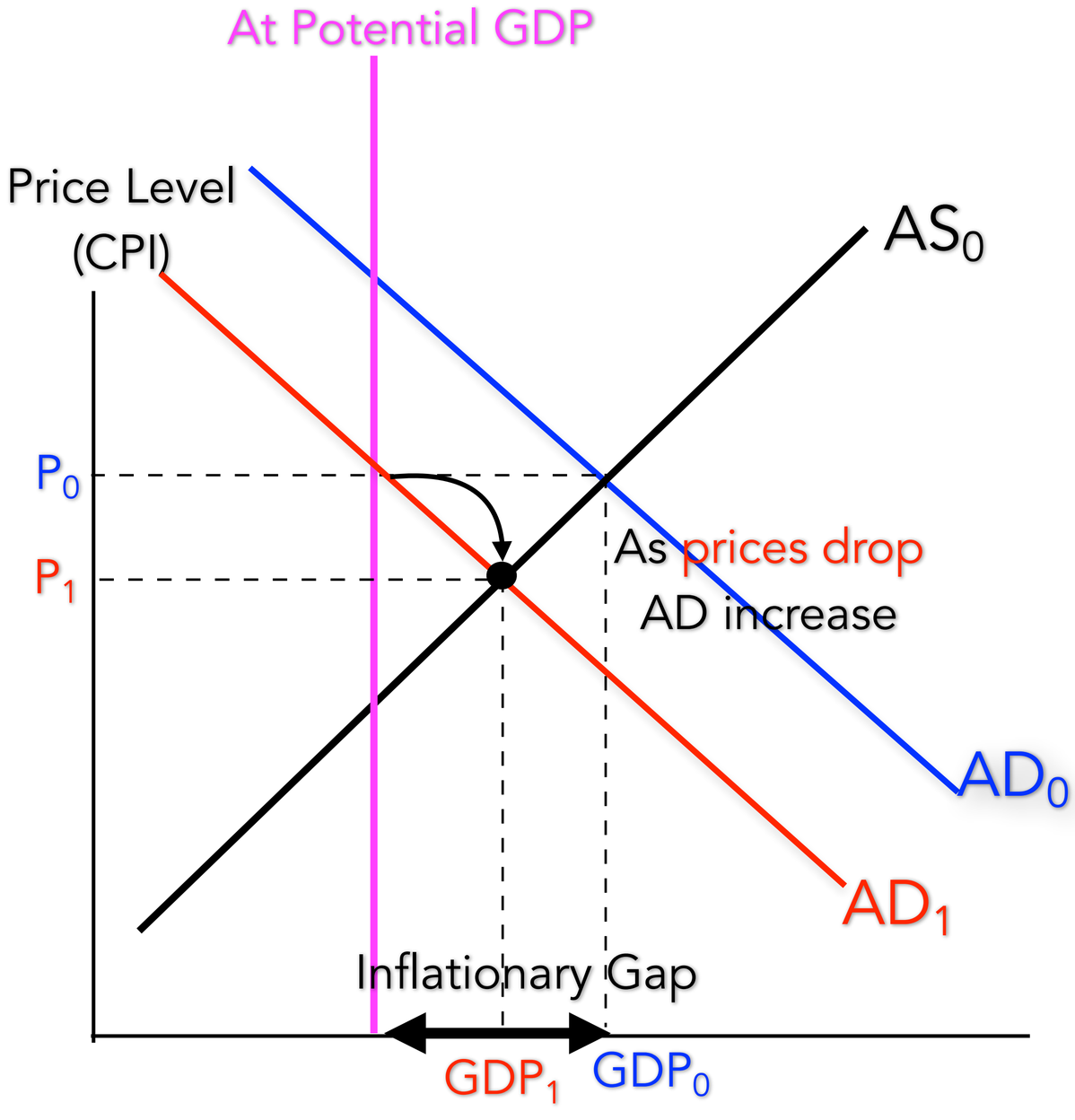
To close an **Inflationary** Gap, Aggregate Expenditures and Aggregate Demand must decrease



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




At Potential GDP
45
AE0
AE1
AE0
Inflationary Gap
GDP0


At Potential GDP
Price Level
(CPI)
AS0
P0
P1
As prices drop
AD increase
AD0
AD1
Inflationary Gap
GDP1
GDP0