

AE_0



Y_0

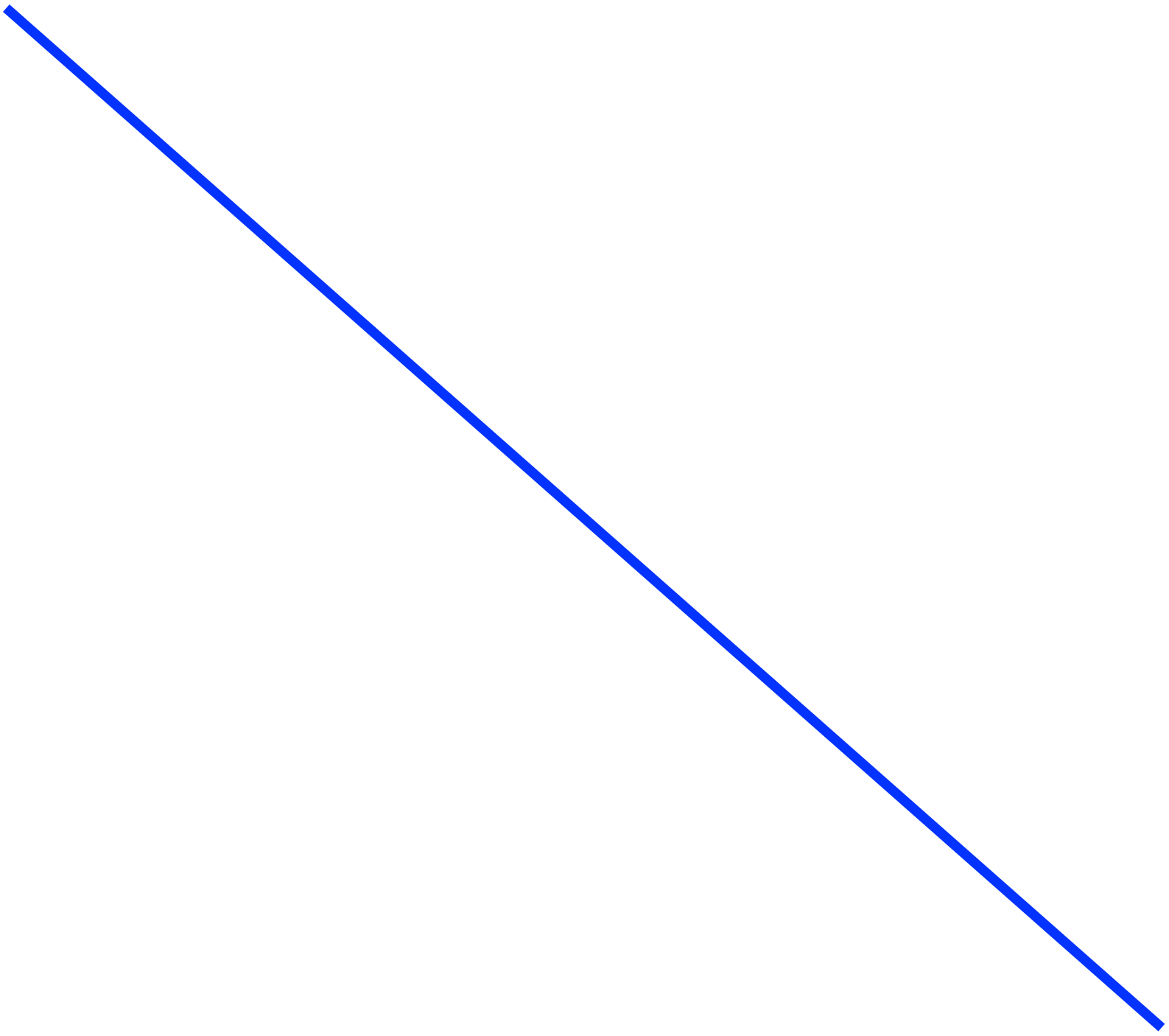
At Potential GDP



Price Level
(CPI)







AD₀

P_1

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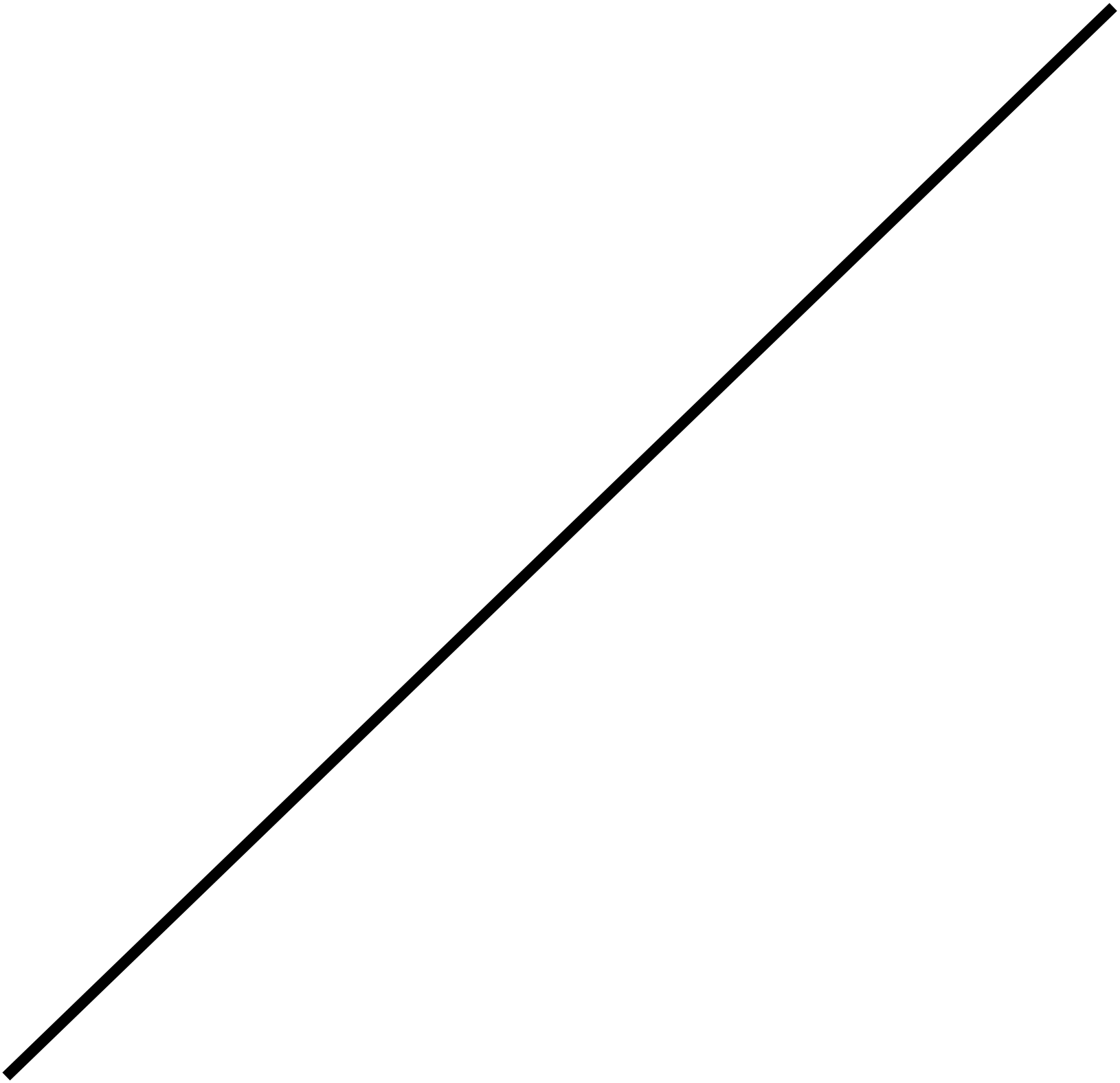
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AS₀



GDP₀

At Potential GDP

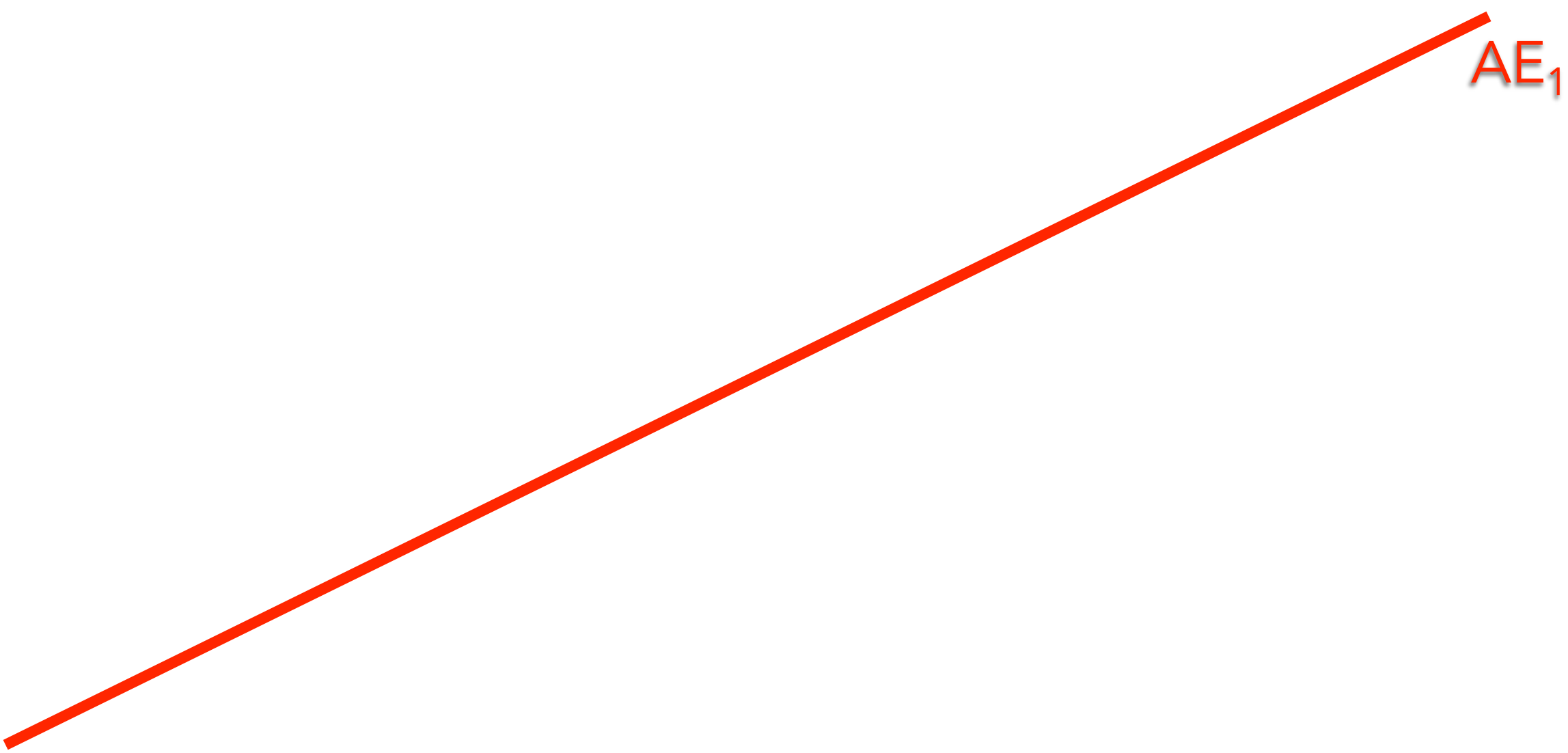


Recessionary Gap



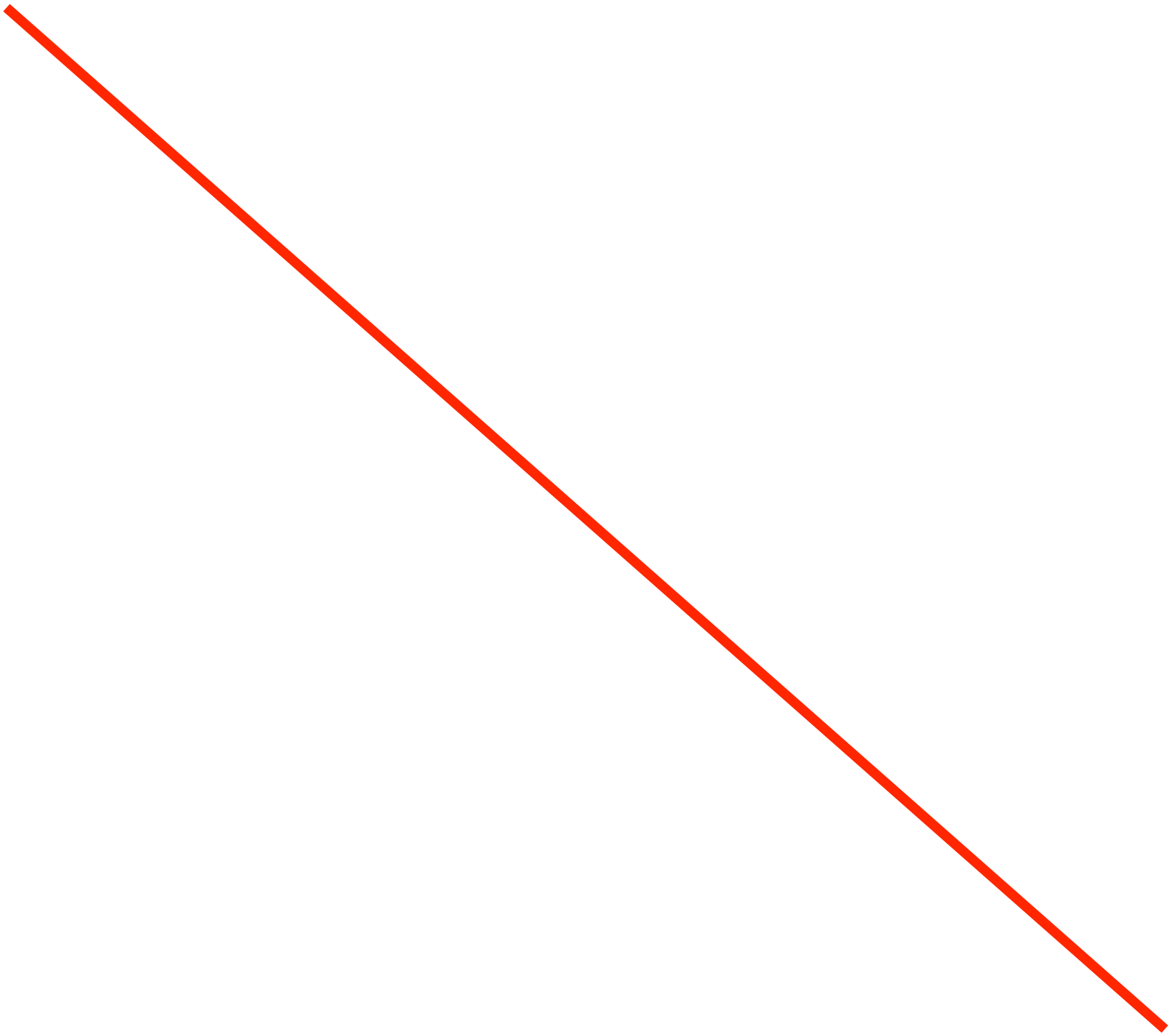
Recessionary Gap





Increase in AD



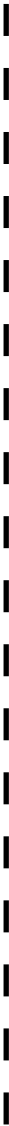


AD₁

To close a **Recessionary** Gap, Aggregate
Expenditures and Aggregate Demand
must **increase**

P_0

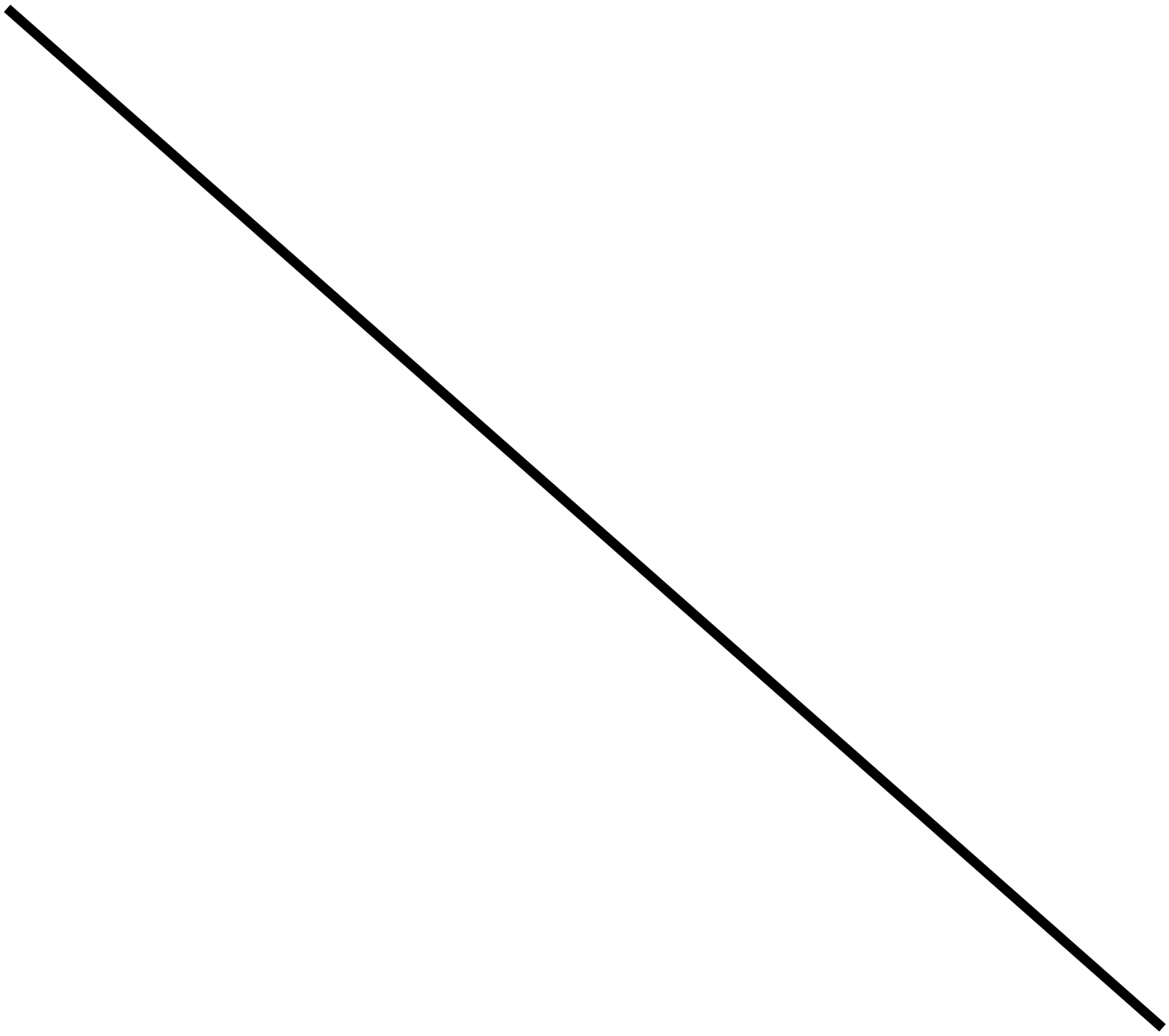
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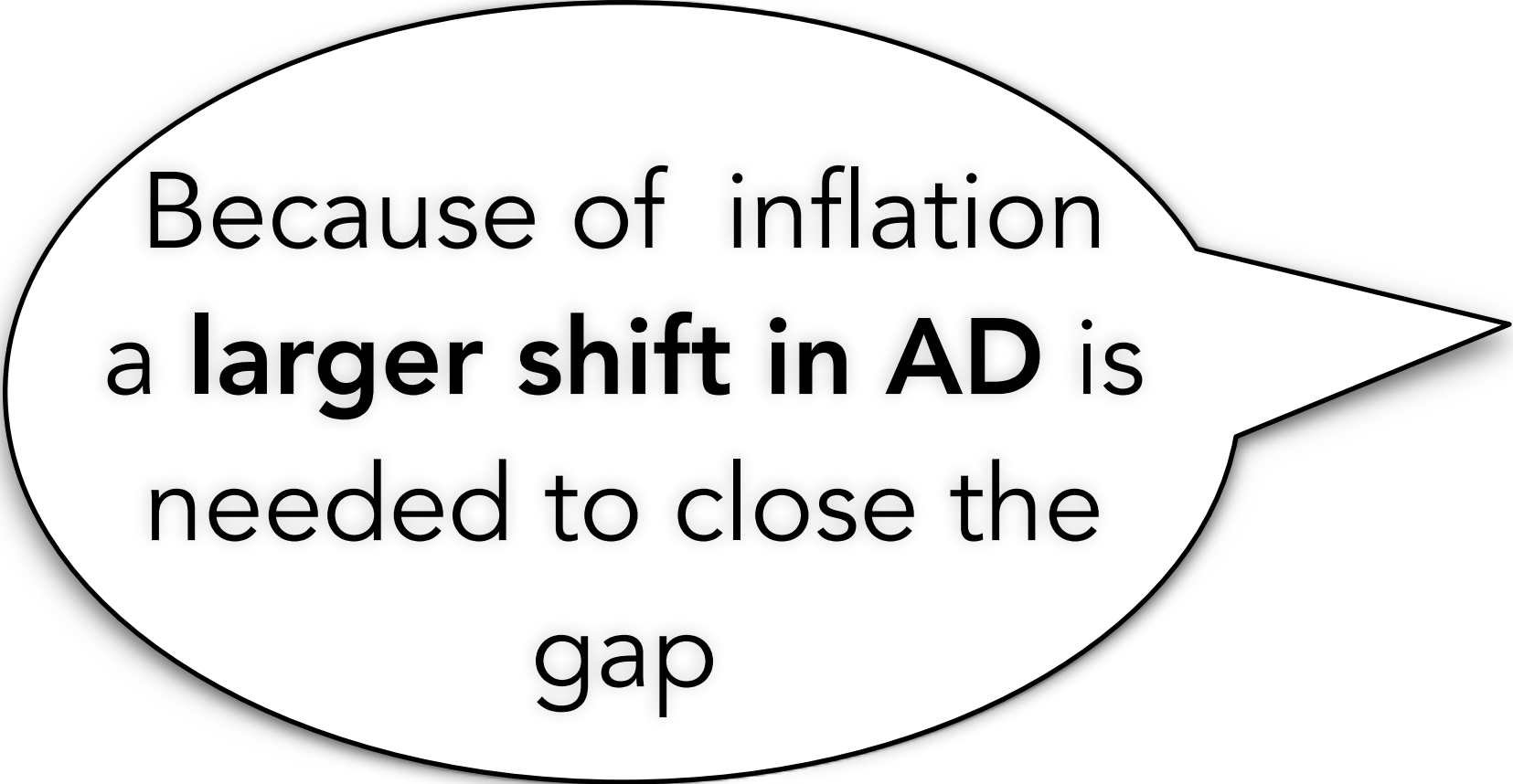
GDP₁



Inflation **reduces** the size of the multiplier

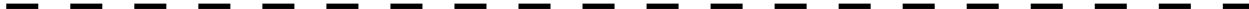


AD₂



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

P_2



GDP₂



Inflation **reduces** the size of the multiplier

