CHAPTER 29

#### CHAPTER 29 - THE AGGREGATE EXPENDITURES MODEL

#### **Consumption and Investment Schedules**

#### The investment demand curve and the investment schedule

- Investment demand investment spending determined by the real interest rate
- Investment schedule shows the amount of investment (I<sub>g</sub>)forthcoming at each level of GDP



# Equilibrium GDP: C + Ig = GDP

- Aggregate expenditures

   (AE) for the private
   closed economy shows the
   amount (C + I<sub>g</sub>) that will be
   spent at each possible
   output or income level
- **DI** = **real GDP**



## **Other Features of Equilibrium GDP**

- Saving and planned investment are equal
- There are no unplanned changes in inventory
- Leakages = injections
- $\mathbf{S} = \mathbf{I}$

## Changes in Equilibrium GDP and the Multiplier

- If interest rate (i) rises, investment spending (I) will decline, by say \$5B
- MPS = 0.25
- m = 1/MPS = 1/0.25 = 4
- Change in GDP due to the rise in investment spending of \$5B = m \* ΔI = 4 \* \$5B = \$20B



## **Adding International Trade**

- A net export schedule will show the net exports that will occur at each level of GDP
- Positive net exports increase aggregate expenditures and GDP
- Negative net exports decrease aggregate expenditures and GDP
- $\Delta X_n = \$5B$
- m = 4
- $\Delta GDP = 4 * \$5B = \$20B$



#### **Adding the Public Sector**

- G expenditure rises by \$20B
- $m = 4, \Delta G = $20B$
- $\Delta GDP = 4 * \$20B = \$80B$



## Equilibrium vs Full Employment GDP

- Recessionary expenditure gap is the amount by which aggregate expenditures *at the full employment GDP* fall short of those required to achieve the full employment GDP
- Inflationary expenditure gap is the amount by which aggregate expenditures *at the full employment GDP* exceed those just necessary to achieve the full employment level of GDP



