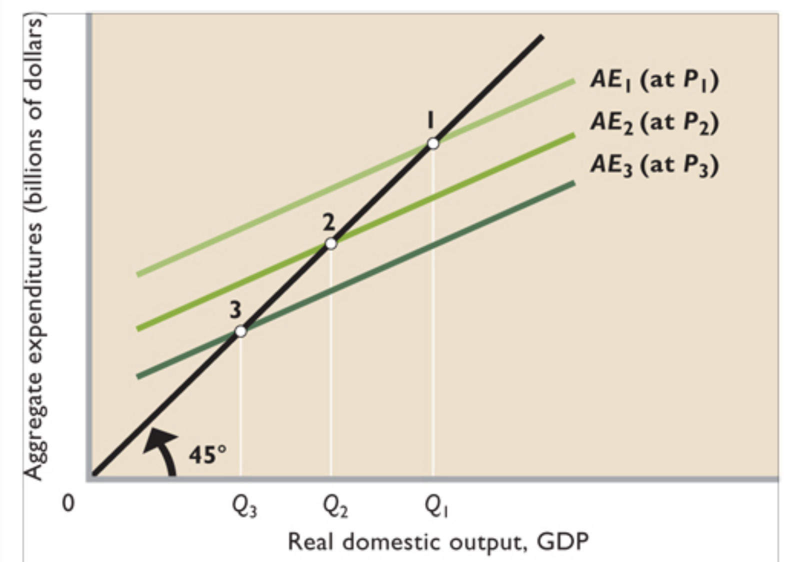
CHAPTER 30

Aggregate Demand - Appendix

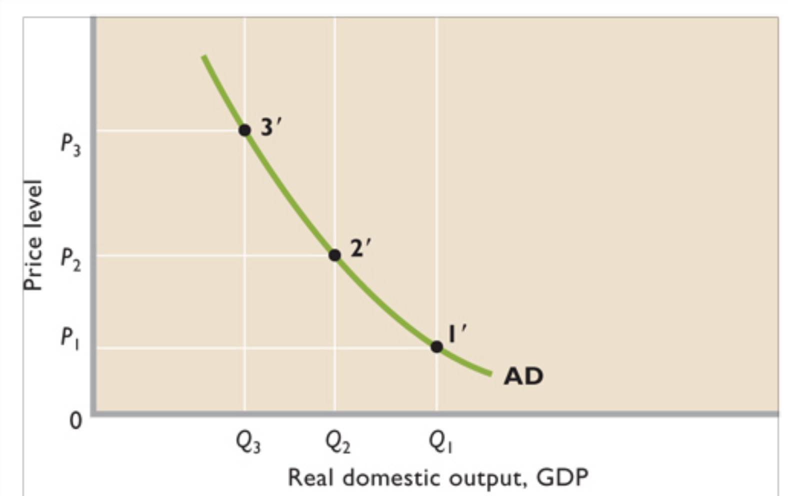
Aggregate demand curve - shows the inverse relationship between the price level and real GDP

- Explanation of AD's negative slope

1. **Real balances effect** - A higher price level reduces the purchasing power of money (savings). Therefore, the higher price level means less consumption spending
2. **Interest rate effect** - As prices rise, demand for money goes up, which will drive up its price, that is, interest rate will rise. Hence, interest-sensitive consumption spending will decline
3. **Foreign purchases effect** - As US prices rise compared to foreign prices, US exports go down



(a)
Aggregate expenditures model

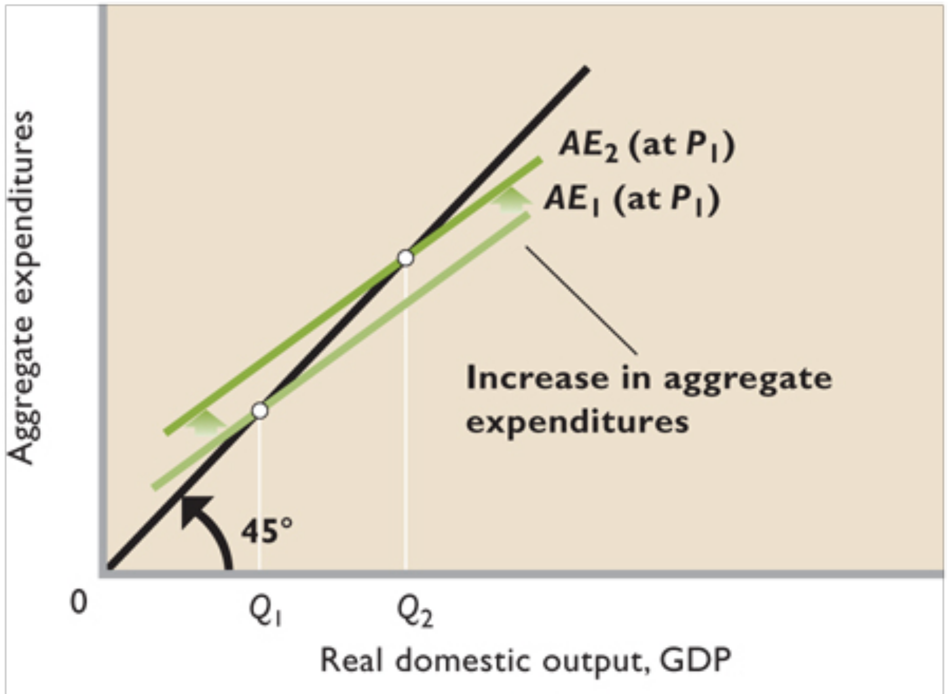


(b)
Aggregate demand–aggregate supply model

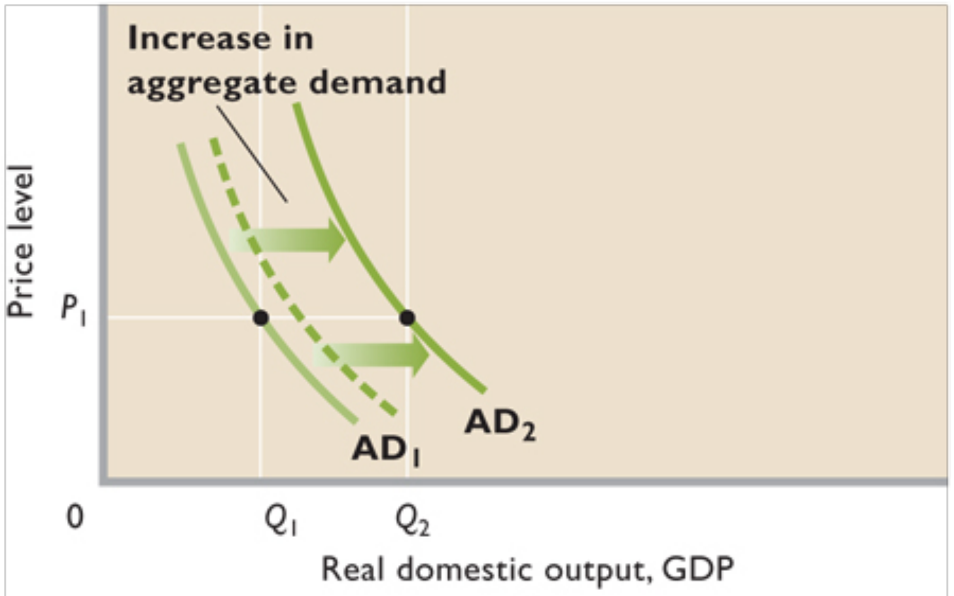
Changes in Aggregate Demand

Determinants of Aggregate Demand (AD)

- Consumer spending (C)
- Investment spending (I_g)
- Government spending (G)
- Net export spending (X_n)



(a)
Aggregate expenditures model

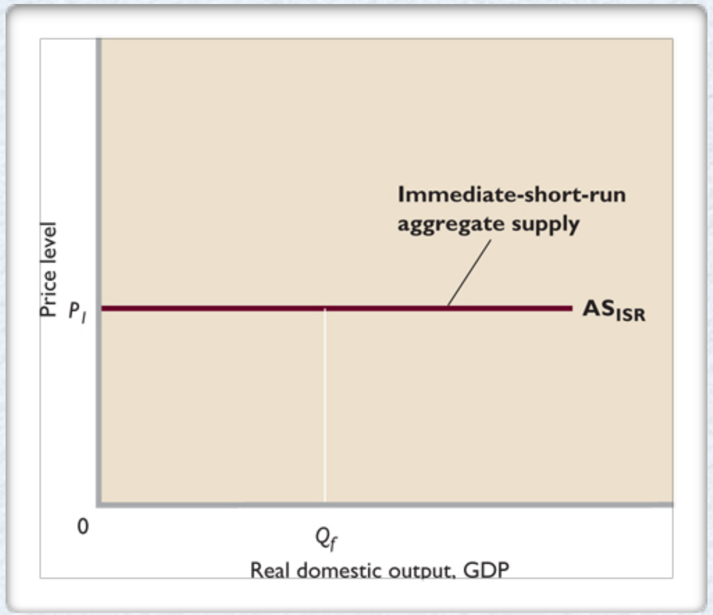


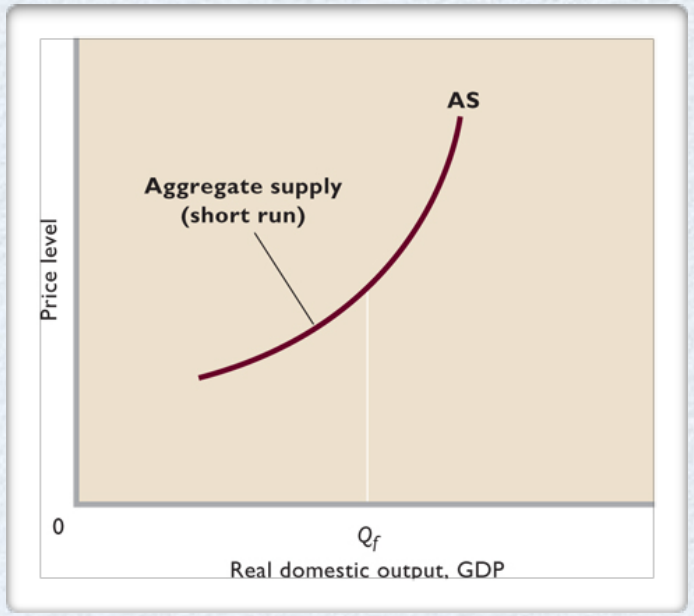
(b)
Aggregate demand–aggregate supply model

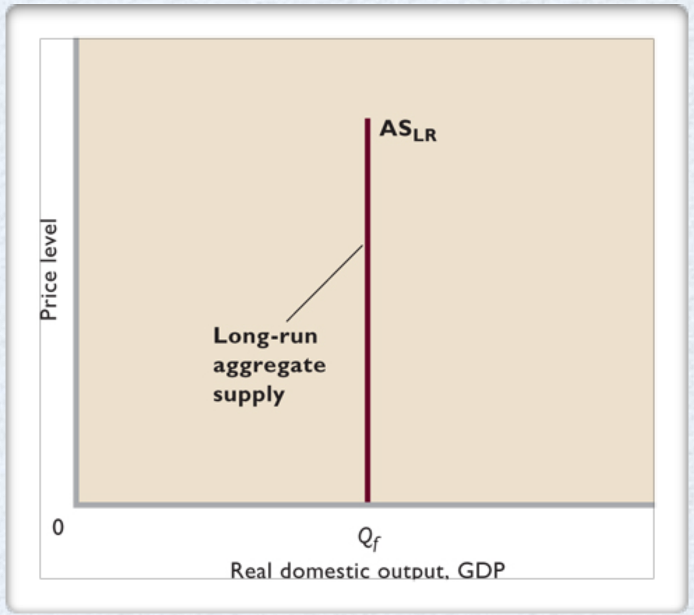
Aggregate Supply

Aggregate supply (AS) in the immediate and short run

- AS is *horizontal* at the economy's current price level in the immediate market period
- AS is *upsloping* in the short run
- AS is *vertical* in the long run at the economy's full employment output level (Q_f)



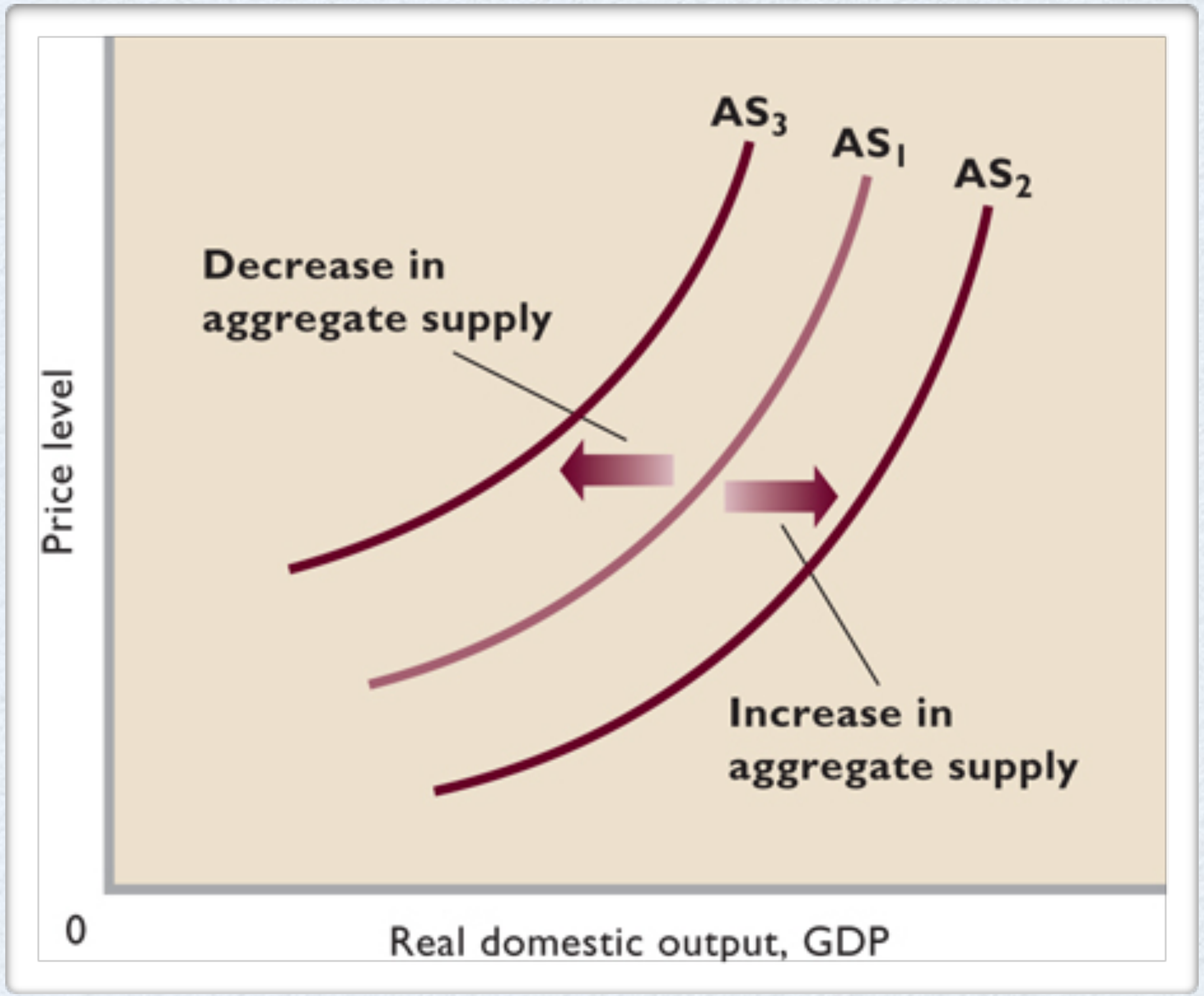




Changes in Aggregate Supply

Shift in Aggregate Supply (AS) - Determinants of AS

- Changes in input prices
- Productivity
- Legal-institutional environment



Equilibrium and Changes in Equilibrium

- **Increases in AD** - demand pull inflation
- **Decreases in AD** - recession and cyclical unemployment
- **Decreases in AS** - cost-push inflation
- **Increases in AS** - full employment with price level stability