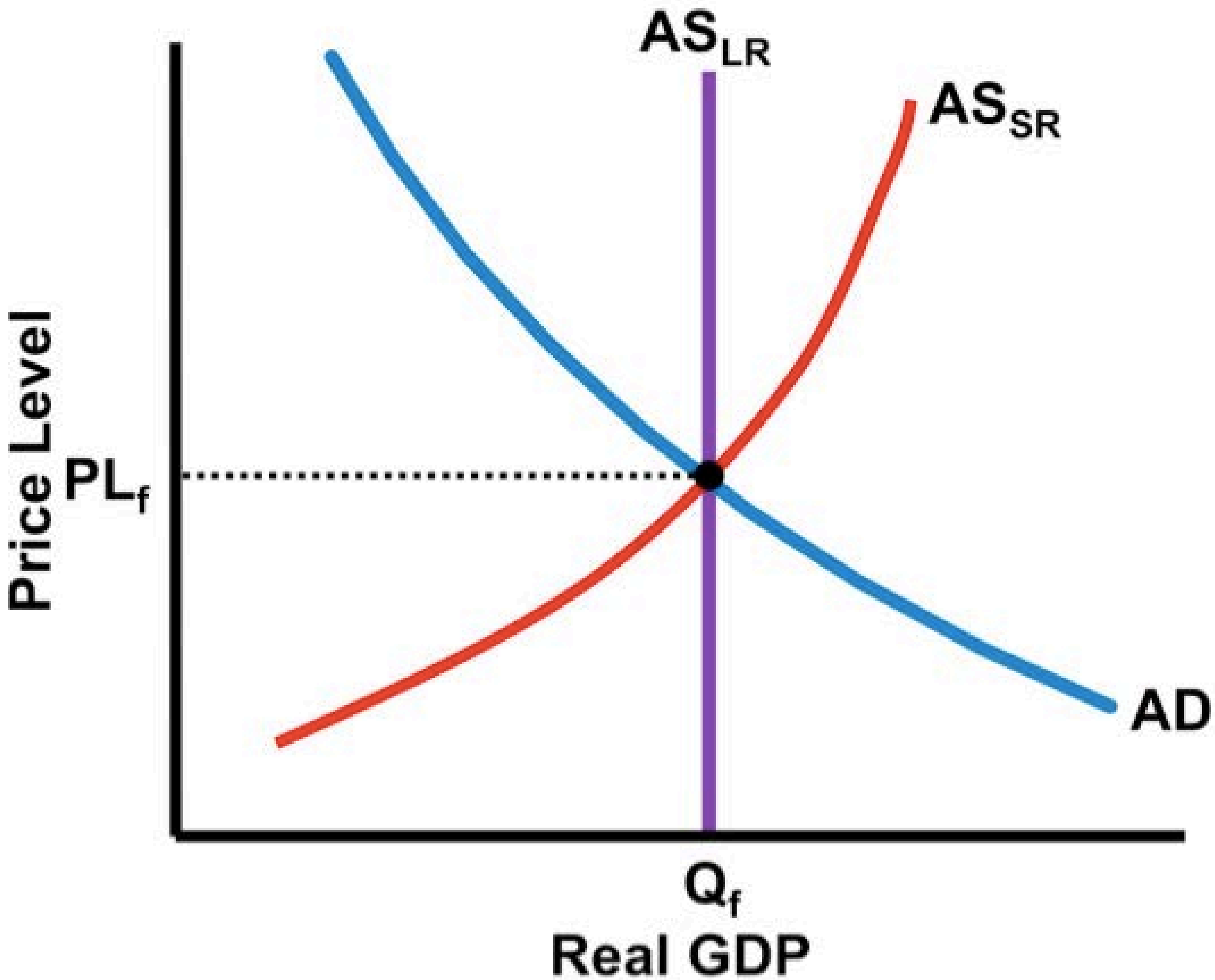
Aggregate Demand/Aggregate Supply Model

Sunday, 22 November 2015 12:16 pm



Shows

- Macro economic Indicators
- Demand / supply side policies

Aggregate Demand

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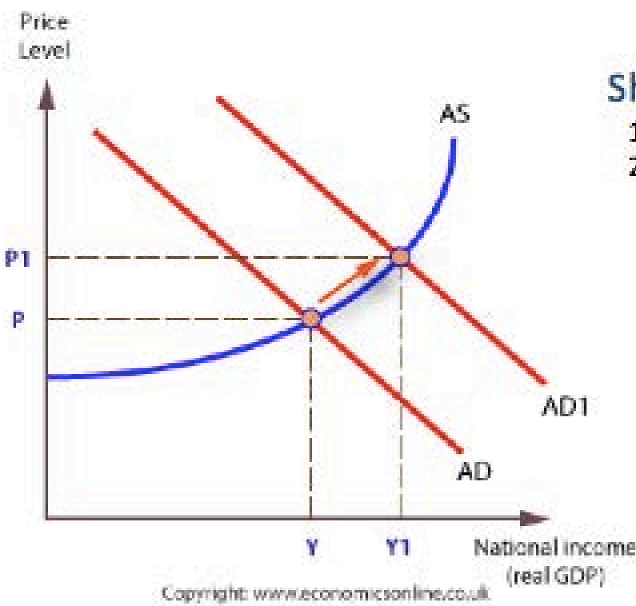
What is Aggregate Demand

Aggregate demand is the **total expenditure** on goods and services in a **period of time** at a **given price level**

Components of Aggregate Demand

C + I + G + NX

1. **Consumer expenditure** - on g/s
2. **Firm Investment** - on assets
3. **Government Spending** - capital / current items
4. **Net Exports** - total export- total import



Shifts in Aggregate Demand

1. Direct relation to RGP and price
2. Employment / wages potentially direct relation

Demand Side Policies: what causes shifts to AD

By changing any of **C + I + G + NX**

Fiscal Policy

Varying overall level of government spending and/or taxation

	Tax Rates	Government Spending	When is it used
Expansionary Fiscal Policy	**Reducing** tax rates: Increase consumer expenditure (more disposable income) More firm investment (more incentive to increase output)	**Increasing** government expenditure	Used in **times of recession**, to boost economic growth and/or increase employment.
Contractionary Fiscal Policy	**Increase** tax rates: Decrease consumer expenditure (less disposable income) Less firm investment (less incentive to increase output)	**Reduce** government expenditure	Used to **reduce inflation / government debt**

Costs of Fiscal Policy

1. Expansionary can lead to more government debt
2. Cumbersome to use: hard to predict how much to cut taxes by etc.
3. Contractionary can reduce innovation by reducing incentive to work
4. Crowding out: private sector lends so much money to government (due to debt), it doesn't have enough for itself

Monetary Policy

Changing the money supply / interest rate

	Interest Rate	Money Supply	When is it used
Expansionary Monetary Policy	**Reducing** interest rates: Cheaper to borrow money, so increase in borrowing, spending	Printing **more** money **Buying** assets from banks - increasing money banks have to circulate	Used in **times of recession,** to boost economic growth and/or increase employment.
Contractionary Fiscal Policy	**Increasing** interest rates: More expensive to borrow money, so reduction in borrowing, spending	Printing **less** money	Used to **reduce inflation / government debt**

Costs of Monetary Policy

1. Depends on customer confidence: lower interest rates doesn't always mean more spending
2. Time lag (when compared to fiscal policy)

Aggregate Supply

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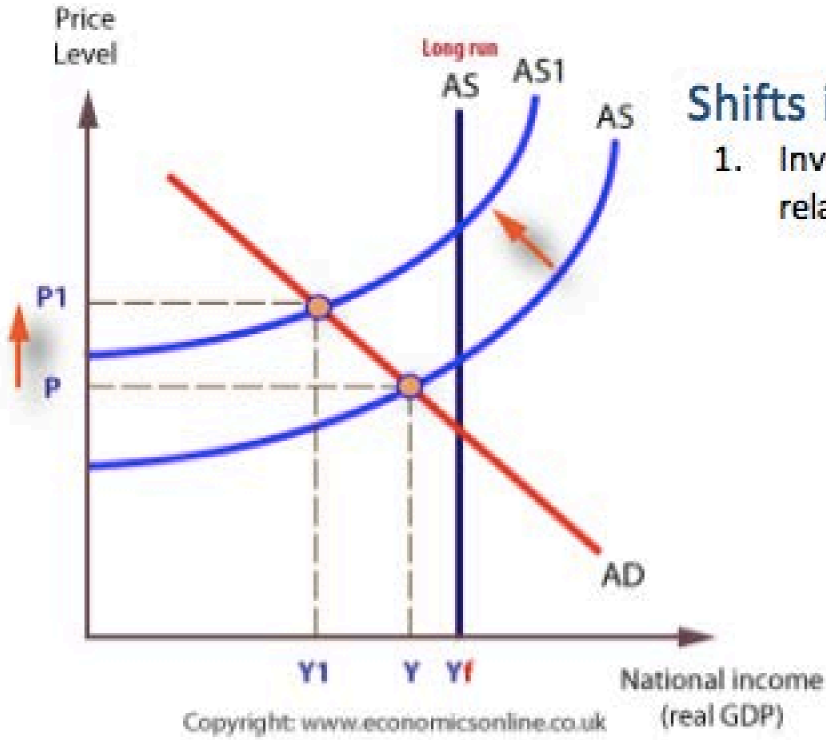

Shifts in Aggregate Supply

1. Inverse relation with price, direct relation to RGPD

Supply Side Policies: what causes shifts to AS

By changing quantity /quality of resources

1. Training / Education -> labor
2. Laws and Regulations -> land use
3. Technological advancements -> capital
4. Specialized subsidies / taxes on specific industries
5. Potentially by privatization