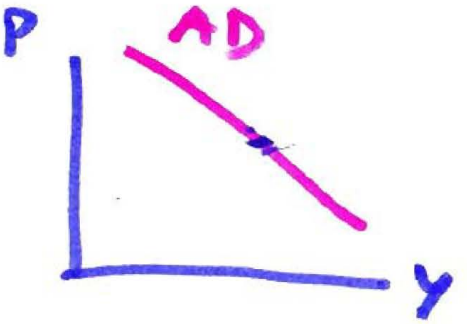
March 6, 2012

1. AS-AD
2. Fiscal Policy + Fiscal Multiplier
3. Monetary Policy
4. International Trade

Aggregate Demand (AD) + Aggregate Supply (AS)

① Aggregate Demand (AD)



** AD is not a sum of all market demands curve

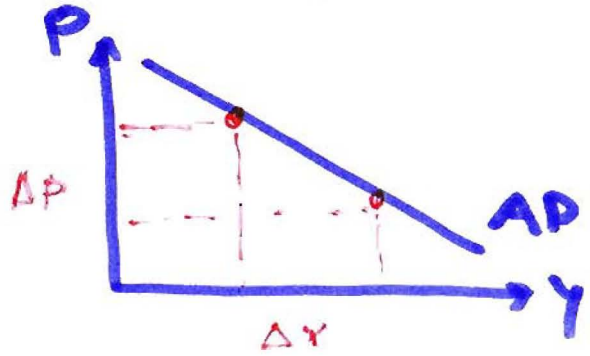
** Each point on the AD curve is a point at which both goods market and the money market are in equilibrium.

AD: Relationship between demand for real gross output (GDP) at every price level (P)

Aggregate Demand (AD)

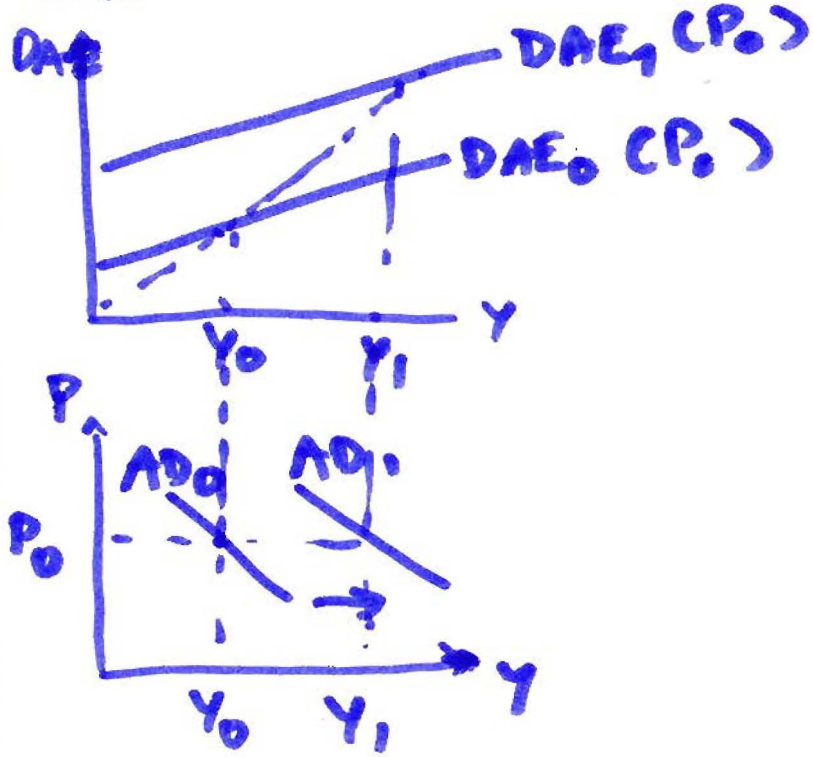
Adjustment # 1

Move along the curve



Adjustment # 2

Shift the curve



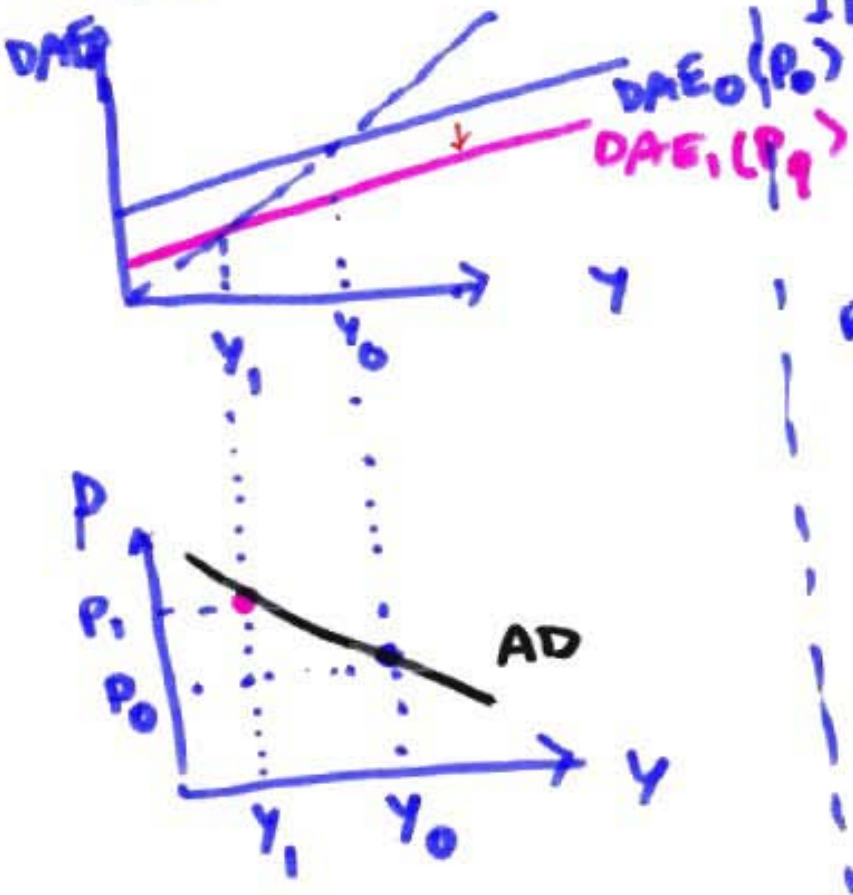
Shift to the right

- MS ↑ money supply ↑
- G ↑ gov expenditure ↑
- T ↓ Tax Rate ↓

Shift to the left

- M^S ↓ money supply ↓
- G ↓ gov expenditure ↓
- T ↑ Tax Rate ↑

Aggregate Demand (AD)



If price ↑ → $DAE_0(P_0)$ shifts to $DAE(P_1)$

P ↑

Relative Price

X ↓ M ↑

Real wealth ↓ (Asset / Price)

C ↓

DAE ↓

($DAE_0(P_0) \rightarrow DAE_1(P_1)$)

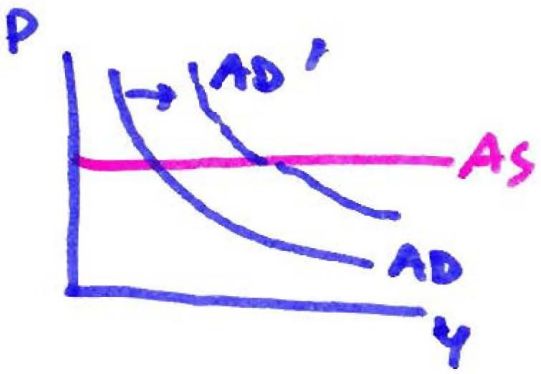
↓

Y ↓

Aggregate Supply (AS): Relationship between gross output (GDP) at every price level (P)

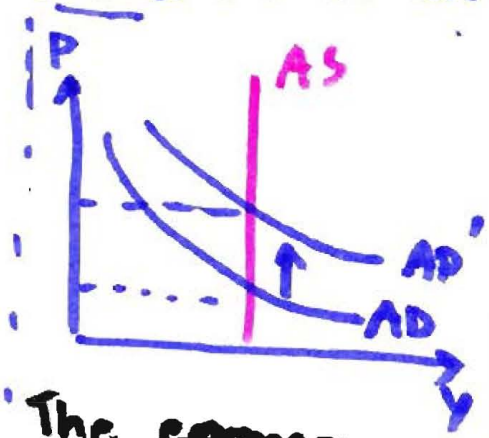
[SHORT-RUN ADJUSTMENT]

CASE I: Keynesian



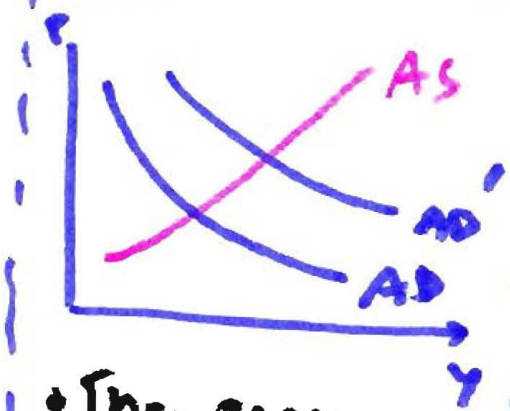
The economy operates lower than the level of full employment. Firms can expand production without increasing prices.

CASE II: Classical



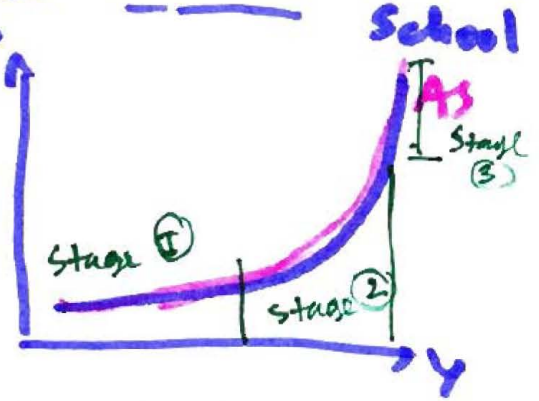
The economy operates at the full employment level. Firms cannot expand production; so, they can only adjust prices of output

CASE III: Non-Keynesian Non-Classical



- The economy operates at lower than full employment level. And Firms can also adjust prices of their output

CASE IV: Mixed School



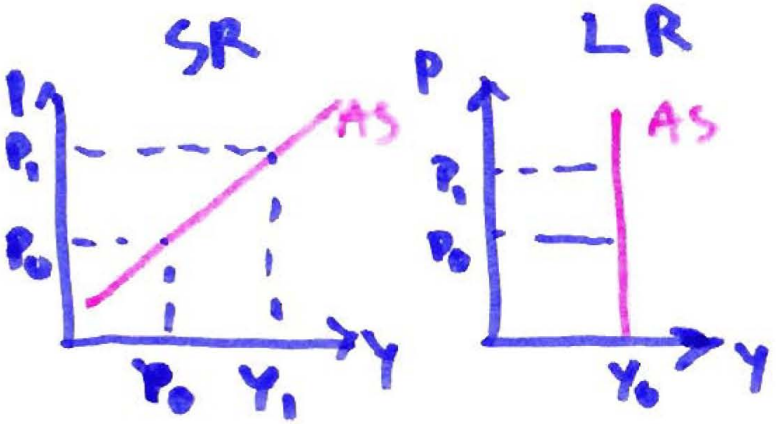
Stage I: Firms can easily expand their production: $\Delta Y > \Delta P$

Stage II: Firms face the constraint of inputs' availability: $\Delta P > \Delta Y$

Stage III: No input available → $\Delta Y = 0$

AS: Adjustmant Mechanism

① Move along the curve



$\Delta P \rightarrow \Delta Y$

② Shift the curve

	Shift to the left	Shift to the right
I	High input cost · Higher wage · Higher raw materials price	Low input cost · Lower wage · Lower raw material price
II	Decreasing Capital stock · Machine ↓ · Building ↓	Increasing capital stock · Machine ↑ · Building ↑
III	Govt Policies · Regulations	Govt Policies · Deregulations
IV	Weather · Bad / disaster	Weather · Good