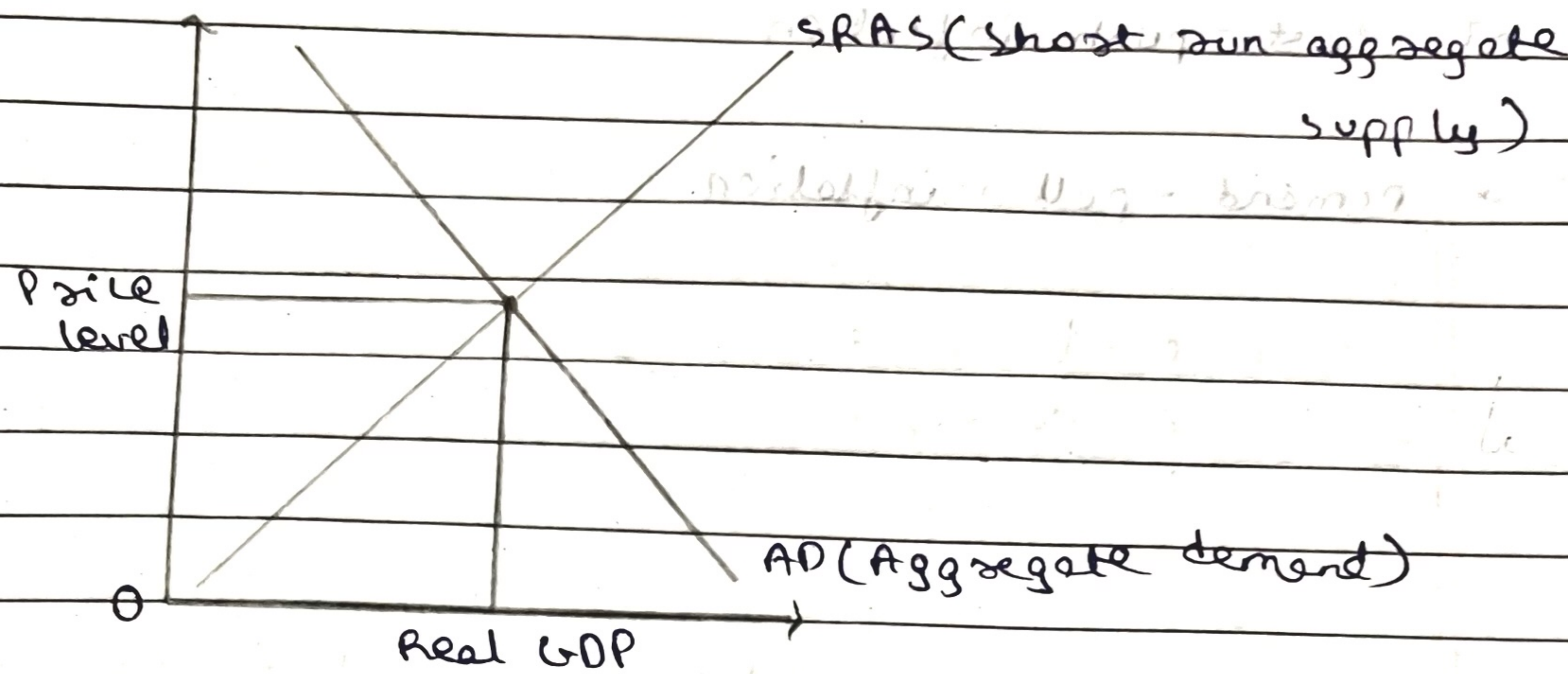
30/9/22

The macroeconomy



- Aggregate demand (AD) is the total amount of output that consumers, firms and government want to buy at each possible price level, over a particular period of time.

- Short run Aggregate supply (SRAS) is the total amount of goods and services produced in an economy (Real GDP) over a particular period of time at different price levels.

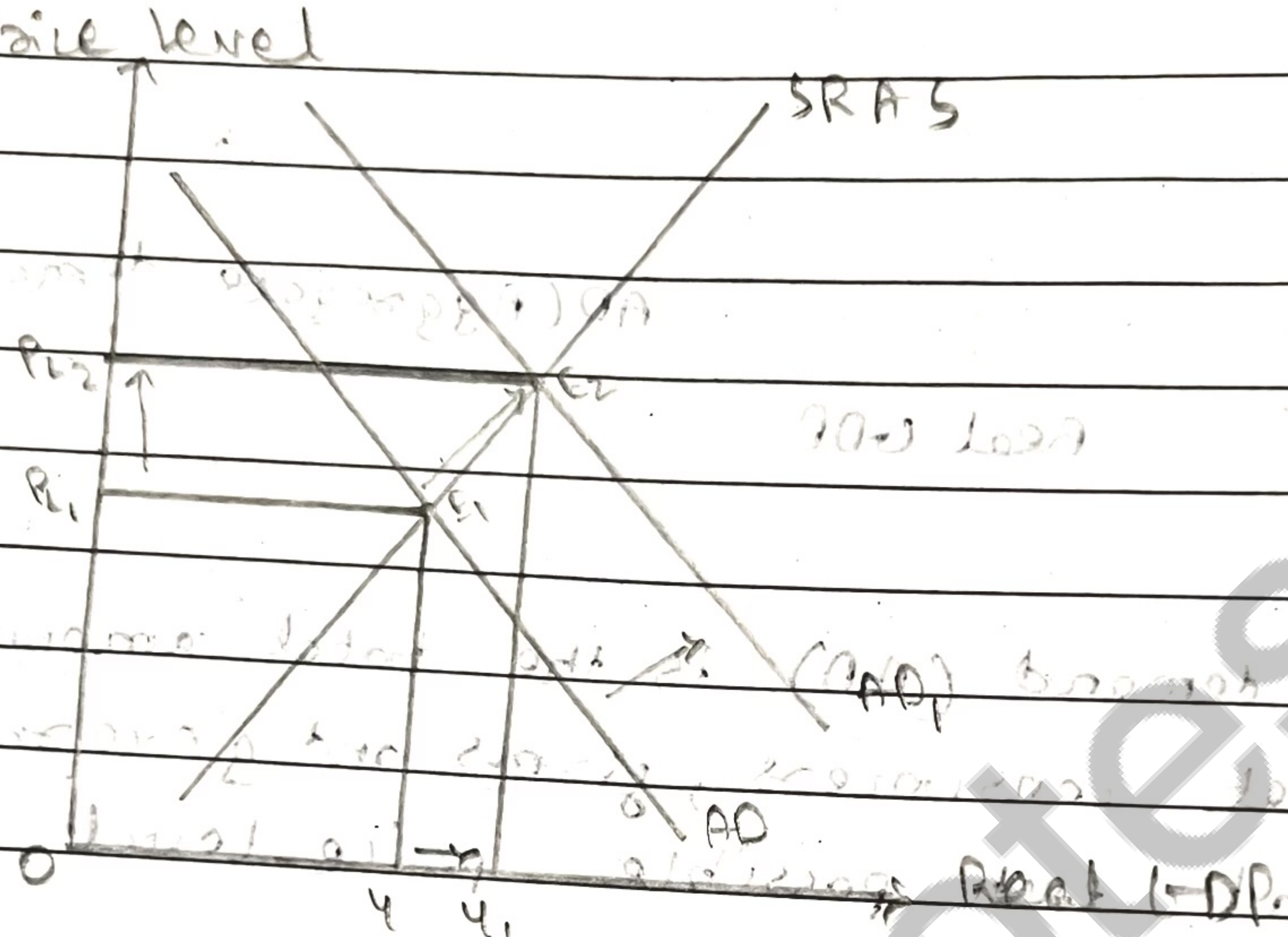
- Inflation refers to an increase in an economy's aggregate price level over a given period of time.

- The inflation rate is equal to the percentage change in the economy's aggregate price level over a given period time.

- Disinflation is a decrease in the aggregate price level rate over a period of time.

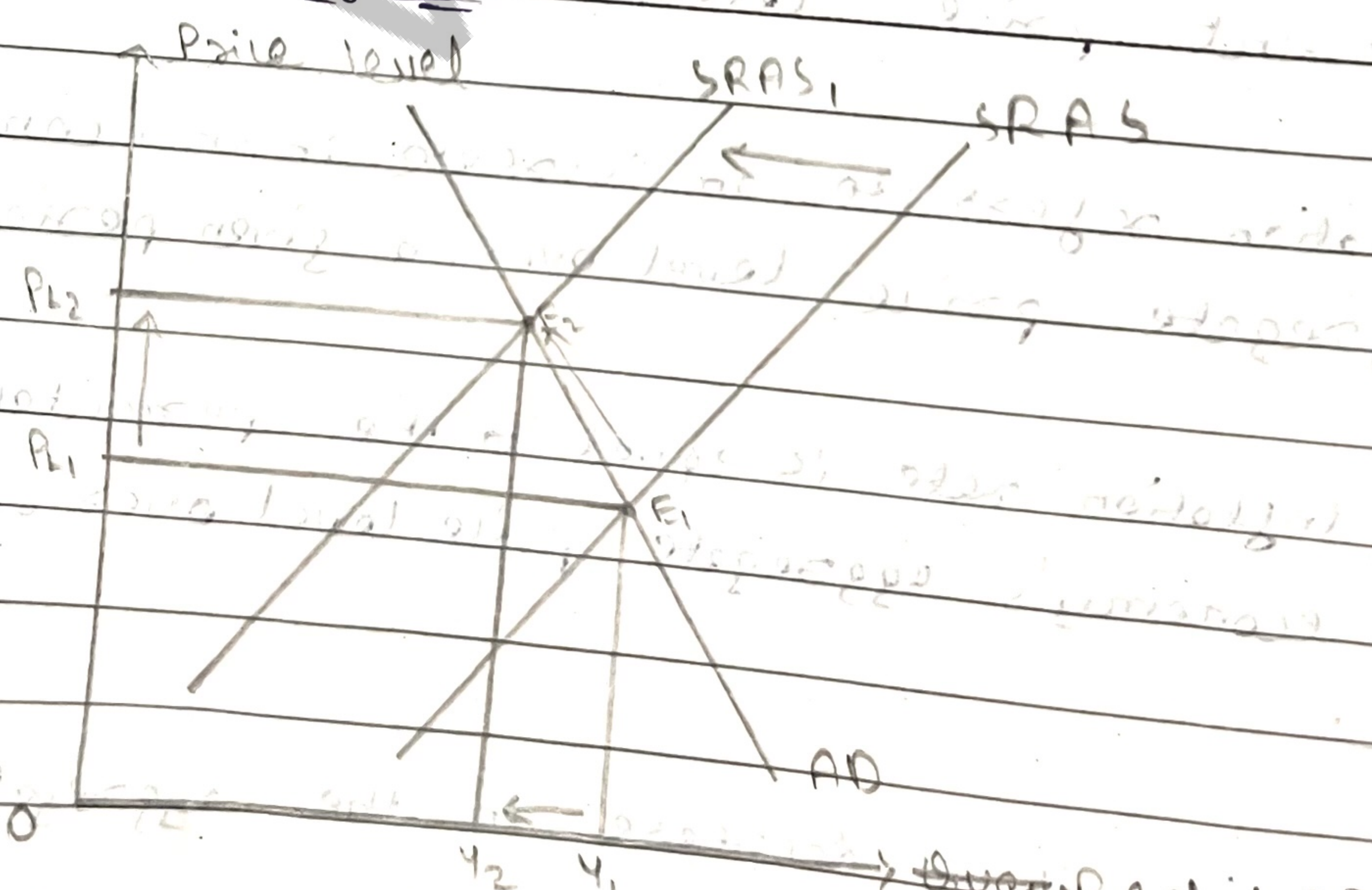
* Causes of Inflation / Types of Inflation
1] Demand - pull inflation
2] Cost - push inflation

* Demand - pull inflation



Inflation that is caused by a unilateral ~~decrease~~ increase in Aggregate Demand (AD) is known as demand-pull inflation.

* Cost - push inflation



Inflation that is caused by a unilateral decrease in Aggregate supply (AS) is known as cost-push inflation.

* **Consequences of Inflation**

- Decrease in the value of money.
- International competitiveness decreases.
- menu costs.
- Investment decreases
- Shoe-leather costs - its the cost of time and energy in running around for cheaper alternatives of goods and investments.

* **Winners and losers of Inflation**

Winner

- People with variable income - firms
- Debtors gain as pay less in reality.

losers

- Creditors will lose.
- People with fixed income.
- Government loses.

15/11/22

DATE :
PAGE NO :

The Macroeconomy

* **Aggregate Demand :-**

→ In an economy, the demand for final goods and services can be divided into 4 main categories :-
1] Consumption (C)
2] Private Investment (I)
3] Government purchases (G)
4] Exports (X)

1] **Consumption (C) :-**

→ Consumption (C) refers to spending by households on consumer goods.

→ A consumer good is a good or service purchased by a household for its own consumption.

* **Determinants of 'C' :**

→ Consumer confidence increases Aggregate Demand increases and vice-versa.

→ Income Tax - low Income Tax, aggregate demand increases and vice-versa.

→ Expectations of changes in future prices - If the future prices are expected to rise people spend more currently, hence the aggregate demand ~~shifts to the~~ increases and vice-versa.

→ Changes in interest rates - higher the interest rate, lower the aggregate demand and vice-versa.

→ Changes in wealth - more wealth leads to increase in aggregate demand and vice-versa.

DATE :
PAGE NO :

* Investment

→ Investment refers to spending by private businesses on capital equipment.

→ It does not refer to as the purchase of financial assets, such as stocks, bonds etc.

* Determinants of (I):-

→ Business confidence
Increased investment as business will produce more as they have confidence in the economy.

→ Interest Rates
Cost of borrowing will increase for firms as a result of higher interest rates, leading to reduced investment. The aggregate demand decreases and viceversa

→ Corporate taxes
If corporate taxes increases, profits are lower which would reduce investment from firms.

→ Level of corporate debts
If debts are higher, then investment is lower as most money is used to pay off the debt.

→ Legal institutional changes
Changes in government laws will lead to changes in investment.

* Government Spending (G)

→ Government spending includes government transfers (
and government purchases of goods and services (G

Determinants of Government spending (G):

* Political priorities
Government has political priorities which affects spen

→ Economical priorities
spending influenced by economic priorities.

* Exports (X)

→ Exports (x) is spending by foreigners on domestically
produced final goods and services.

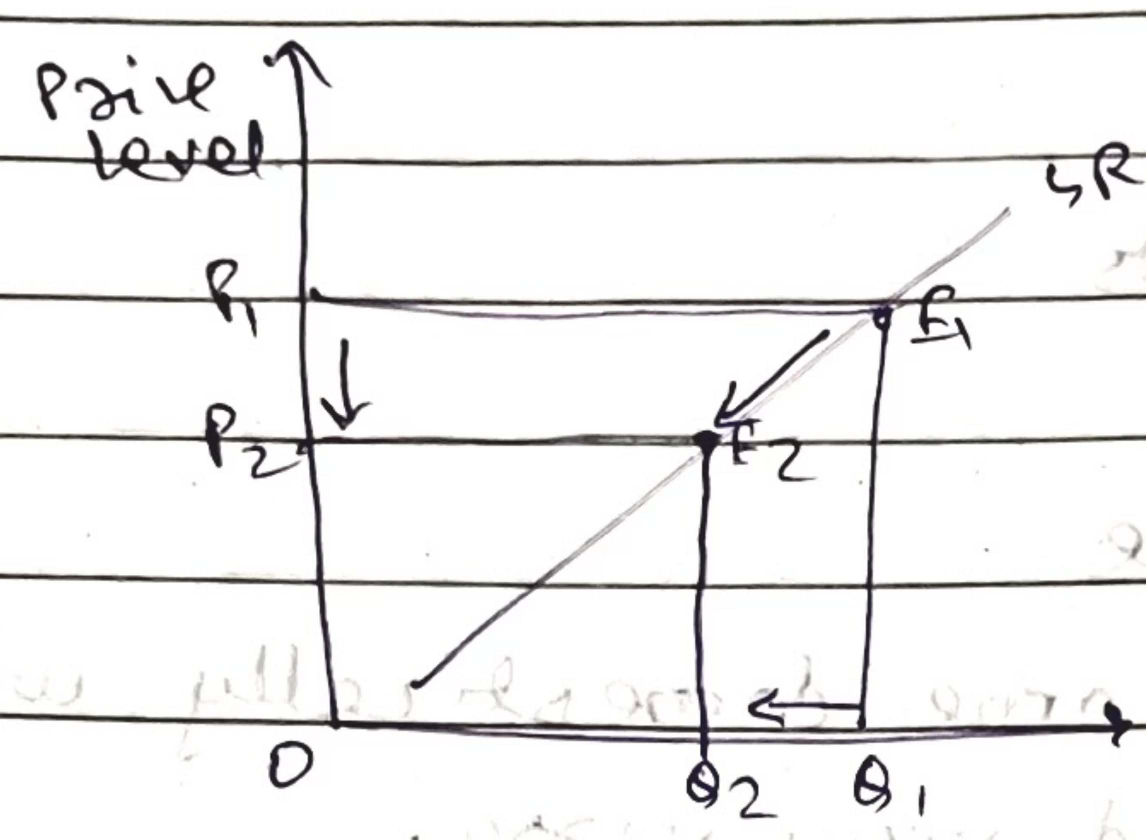
Determinants of exports

→ National Income Abroad
If income of individual increases abroad, they will
demand more leading to an increase in exports and
vice-versa.

→ Exchange rates (currency rates)
Currency appreciation will lead to decrease in exports
and vice-versa.

* **Aggregate Supply :-**

* **Short-run Aggregate Supply (SRAS)**

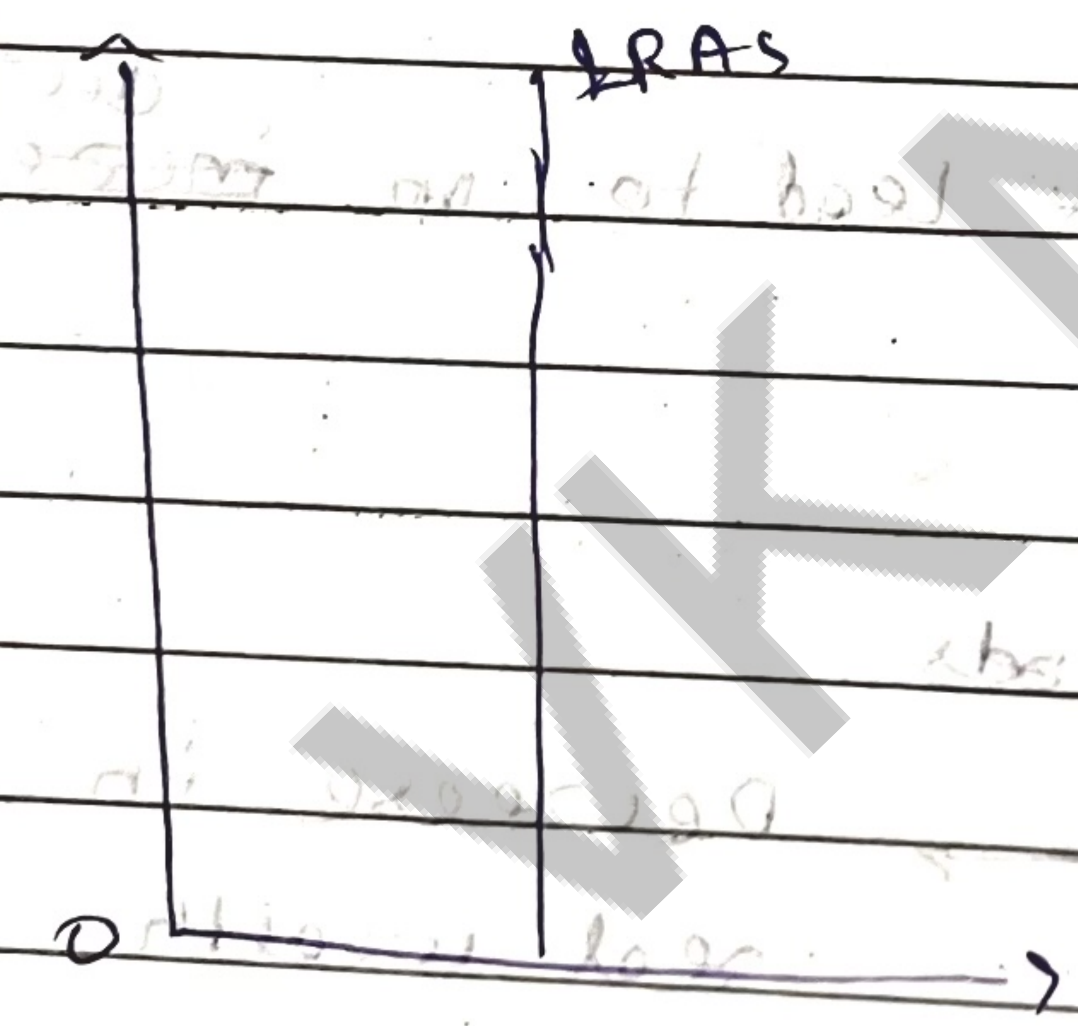


Price level decreases
$P_1 \to P_2$
Contraction in Aggregate Supply

Aggregate Output

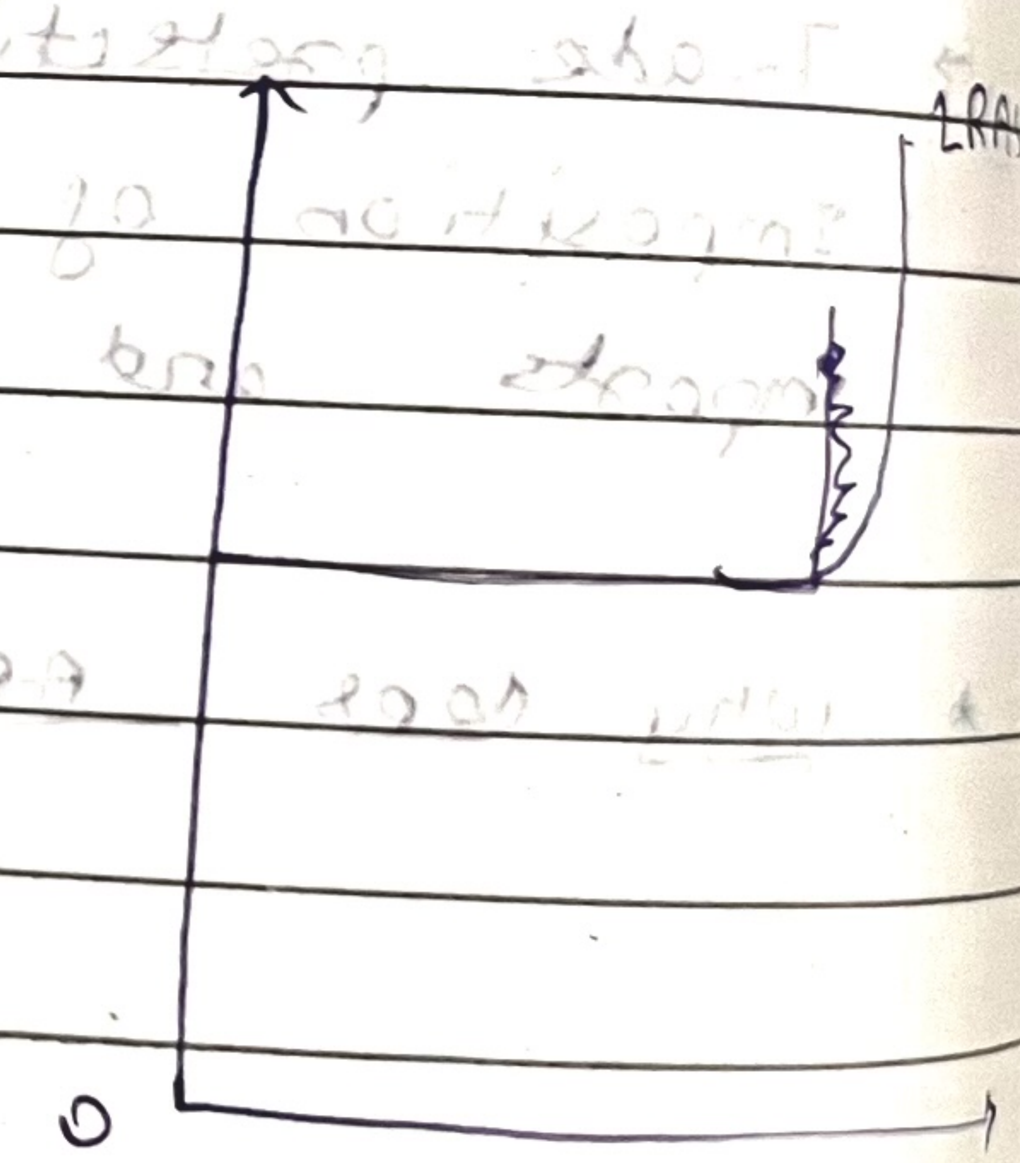
* **Long-run aggregate supply (LRAS)**

Monetarist



(fixed supply)

Keynesian ~~Monetarist~~



* An Aggregate supply (AS) curve shows the total quantity of final goods and services supplied by domestic firms over a given period of time and for any given price level.

* Imports (m)

→ Imports (m) is spending by residents on non-domestic goods and services.

* Determinents of Imports

→ Domestic National Income
Increase in national income domestically will lead to an increase in imports and vice-versa.

→ Exchange rates
Currency appreciation will lead to an increase in imports and vice-versa.

→ Trade protectionism
Imposition of ~~tax~~ tariffs will lead to an ~~increase in~~ decrease in imports and vice-versa.

* Why does AD slope downwards

Increase in price level →

- Wealth effect → Decrease in real wealth → Decrease in C
- Interest rate effect: Increase in demand for money → Increase in interest rate → Decrease ~~Increase~~ in C and I
- International trade effect → lower international competitiveness → Decrease in net exports

This leads to decrease in Aggregate quantity ~~demanded~~ level

* The short-Run Aggregate supply curve

→ In the short Run, input prices are assumed to be fixed.

→ In particular, (nominal) wages are inflexible in the SR because they are set by contracts that were signed some time ago.

→ It follows that (nominal) wages are slow to fall even in the face of high unemployment and slow to rise even in the face of labour shortages.

→ This phenomenon is known as sticky wages.

→ The short-Run Aggregate supply (SRAS) curve shows the total quantity of final goods and services supplied by domestic firms, for any given price level and when input prices can be taken as fixed.

* Shifts of the SRAS curve

→ Increase in the corporate taxes leads to decrease in the aggregate supply and cause a shift to the left and vice-versa.

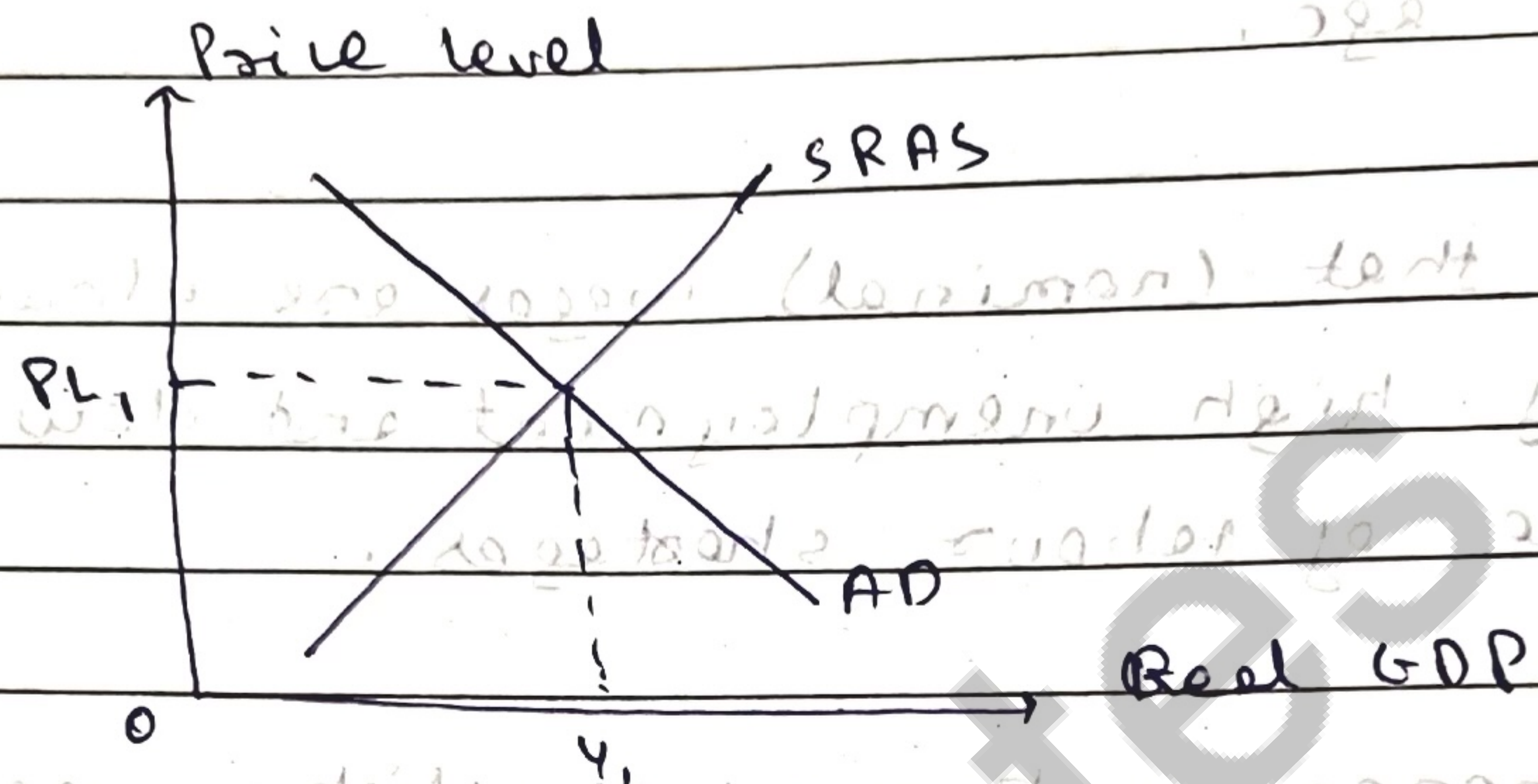
→ More subsidies lead to shift of aggregate supply to the right and vice-versa.

→ Increase in wages leads to shift of AS to the left and vice-versa.

→ Supply shocks

* Short-Run macroeconomic Equilibrium

→ It is when the aggregate demand in an economy is equal to the aggregate supply in the short run.



* The Long-Run supply curve
Monetarist curve.

→ In the LR, contracts for wages will be renegotiated to take into account changed economic circumstances so input prices are flexible.

→ The Long-Run Aggregate Supply (LRAS) curve shows the total quantity of final goods and services supplied by domestic firms for any given price level and when input prices are flexible.

3/1/23

Deflation

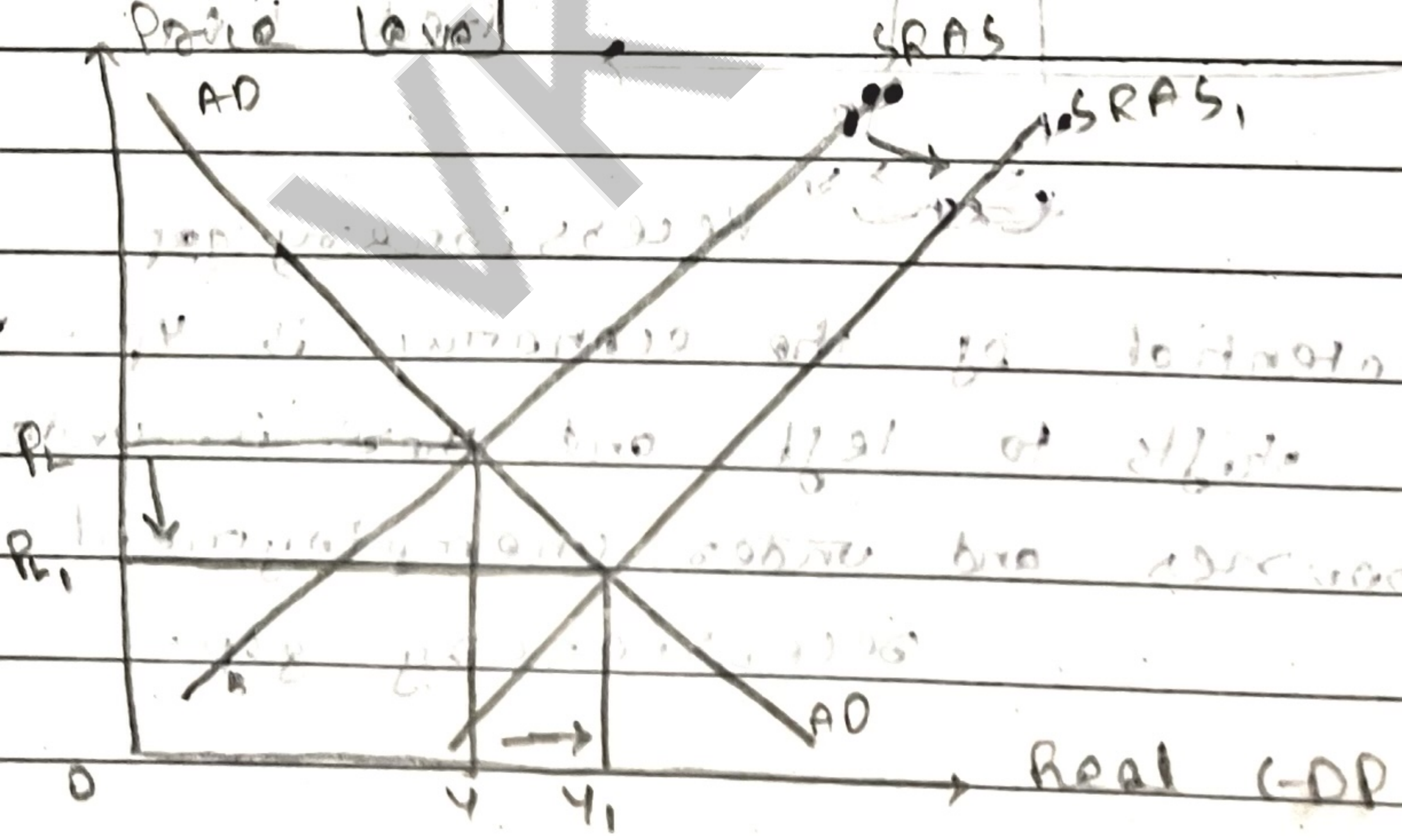
→ Deflation refers to as a sustained decrease in the general price level of an economy over a given period of time, generally a yea[r]

→ There are 2 types of deflation- Good deflati[on] and bad deflati[on]

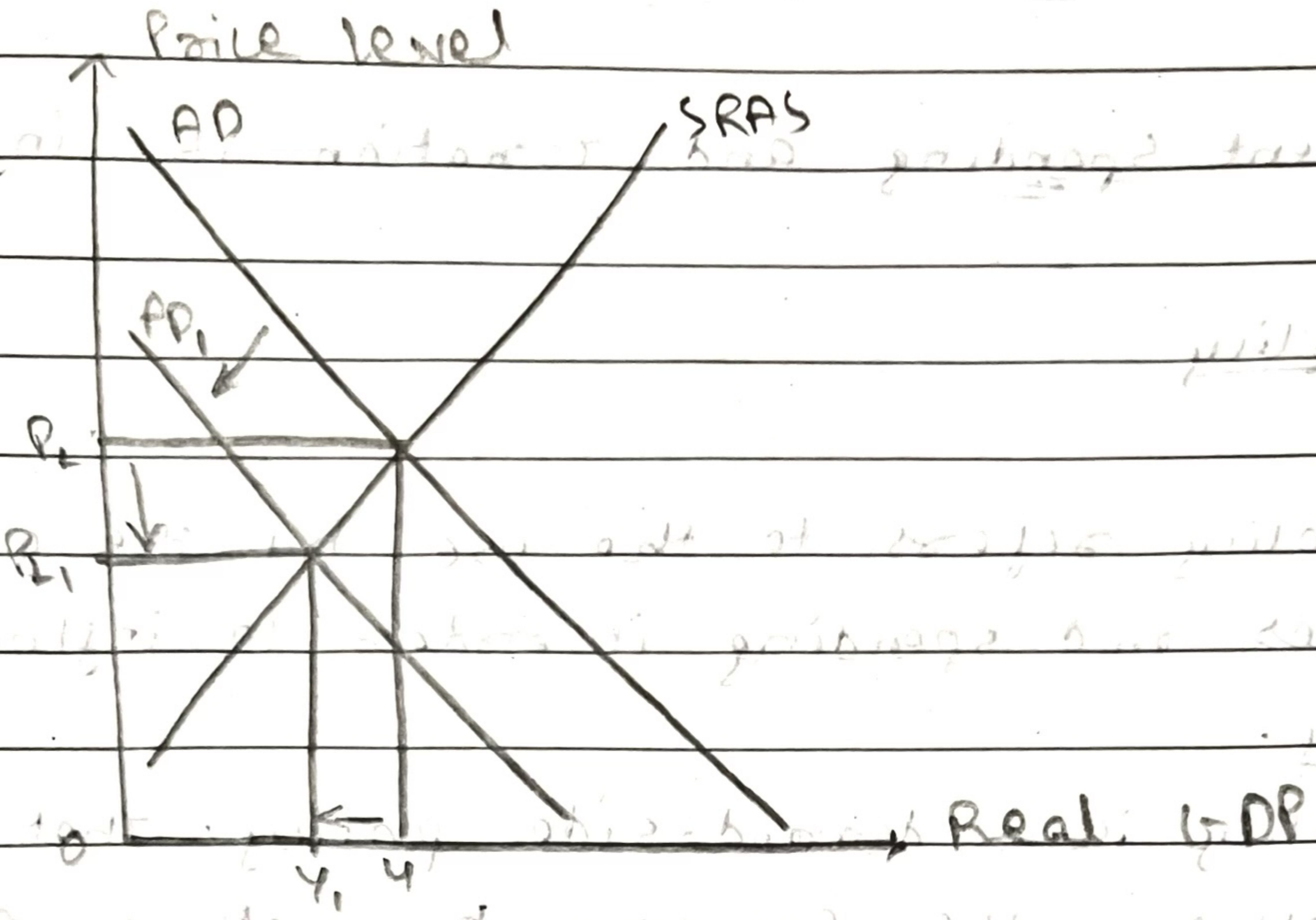
→ Good deflation is caused because of a rise in the aggregate supply of an economy.

→ Bad deflation is caused because of a fall in the aggregate demand in an economy.

* Good deflation



* Bad deflation



* Consumer Price Index (CPI)

→ The CPI is a measure of the cost of living for the typical household, and compares the value of a basket of goods and services in one year with the value of the same basket in a base year.

* Negatives of CPI

→ Not all goods are included, so inaccurate results are possible.

→ Substitutability.

→ Doesn't account for increase in quality.