Getting ready for the AP Macroeconomics Exam

Lesson 4

Aggregate Supply and Demand Model (SR vs. LR), Economic Phenomena / Economic Gaps

Reasons for Change of AD / AS

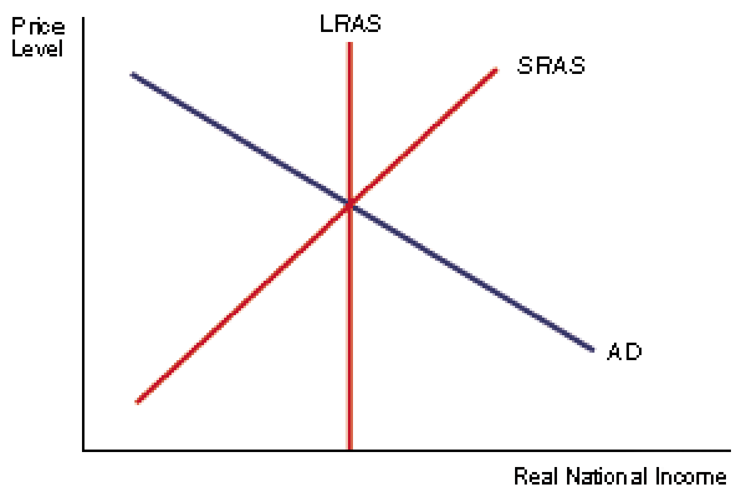
Fiscal Policy

What is AD / AS?

Aggregate demand is the sum of all demand / **consumption** in an economy. This can be computed by adding the expenditure on consumer goods and services, investment, government spending, and net exports (total exports minus total imports).

Aggregate supply is defined as the total of all goods and services **produced** by an economy over a certain period of time. When people talk about supply in the U.S. economy, they are usually referring to aggregate supply, and the typical time frame is a year

Graph



Changes in Demand and Supply
Vs.
Changes in Aggregate Demand and Aggregate Supply

Changes in Demand	Changes in Aggregate Demand
- consumer expectations - consumer taste - number of consumers in the market - change in income - price of substitute goods - price of complementary goods	- foreign exchange rate of the U.S. $ - security about jobs and future income - economic conditions in other countries - real interest rate - taxes - amount of money in circulation
Changes in Supply	**Changes in Aggregate Supply**
- costs of inputs to production process - technology - number of producers in the market - government policies	- availability of raw materials - input prices - competition - international trade barriers - regulatory impediments to businesses - labor supply - education and training of employees - marginal tax rate

Economic Phenomena / Economic Gaps

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<tr><th>Recession ☹ ☺</th><th>Inflation ☹ ☺</th></tr>
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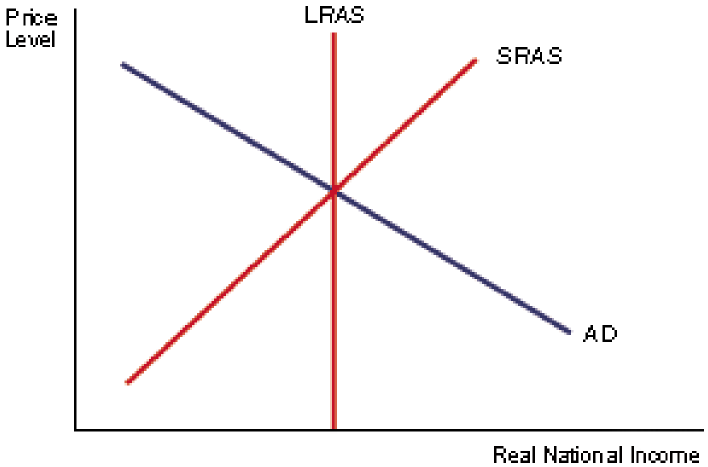

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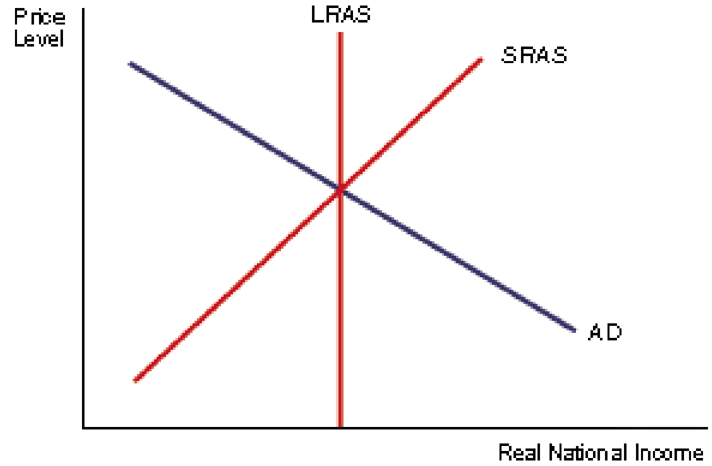

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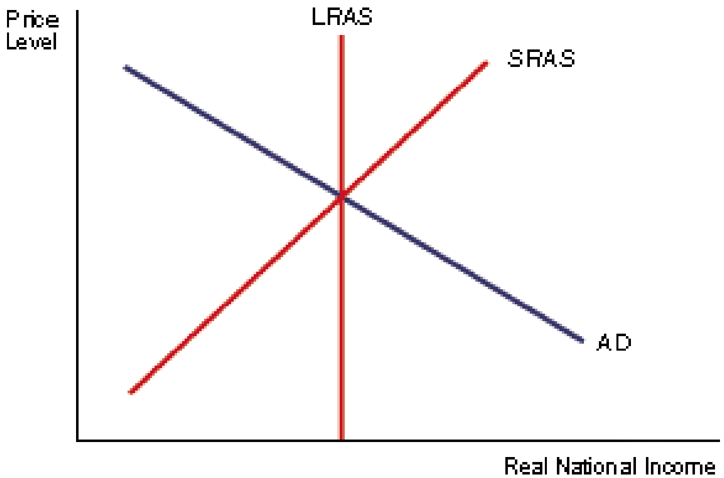
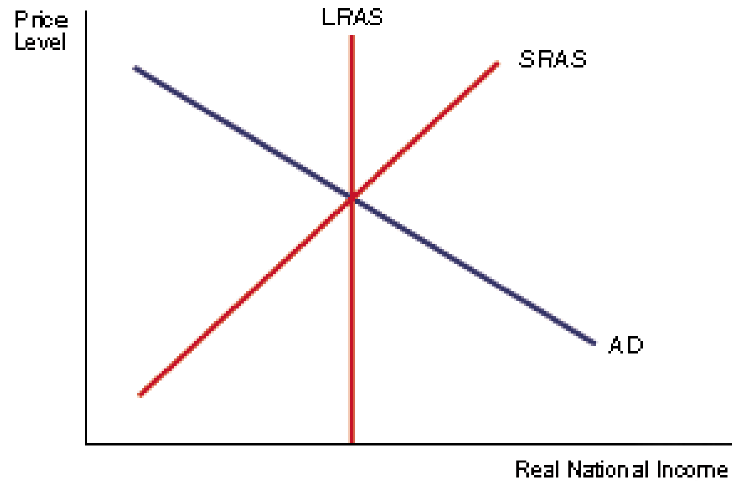
Stagflation ☹☹☹	**Economic Growth SR / LR ☺☺☹**
	

Fiscal Policy

Expansionary Fiscal Policy	Contractionary Fiscal Policy
Tools: Increase Gov.-Spending Decrease Taxes	Tools: Decrease Gov.-Spending Increase Taxes
Applied during which phase of the business cycle: Recession Recessionary Gap Contractionary Gap !!!!	Applied during which phase of the business cycle: Inflation Inflationary Gap Expansionary Gap
How will the tools you identified impact components of the expenditure model of GDP= C+I+G+NX Increase in Gov.-Spending will lead to an increase in AD Decrease in taxes will lead to a) More disposable income for households - hence increase in consumption C and therefore increase in AD b) Higher profits for businesses – hence increase in investment spending I and therefore increase in AD	How will the tools you identified impact components of the expenditure model of GDP= C+I+G+NX Decrease in Gov.-Spending will lead to an decrease in AD Increase in taxes will lead to a) Decline of disposable income for households - hence decrease in consumption C and therefore decrease in AD b) Lower profits for businesses – hence decrease in investment spending I and therefore decrease in AD
How will the tool you identified affect the AD curve? **Increase in AD**	How will the tool you identified affect the AD curve? **Decrease in AD**