1. Aggregate Demand and Aggregate Supply

2. Macroeconomic Equilibrium

Aggregate demand

is a relationship between aggregate quantity demanded and the economy's price level.

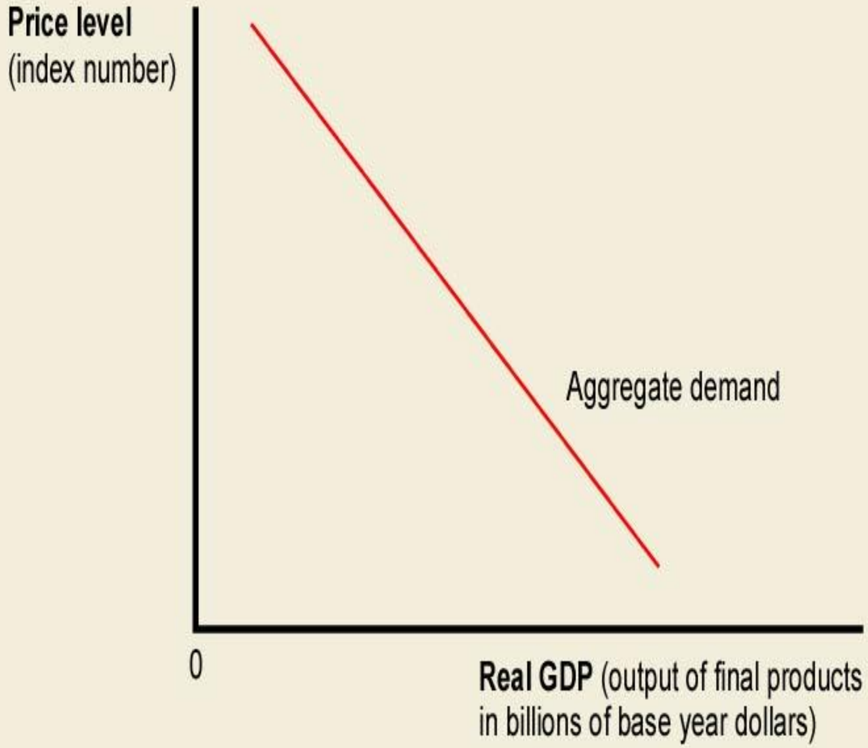
Aggregate quantity demanded *the amount of final products (measured as real GDP) buyers will purchase at a given price level is called*

Aggregate demand curve, a graph that shows how aggregate quantity demanded varies with the price level for the economy. A downward-sloping aggregate demand curve implies that the lower the price level, the greater the aggregate quantity demanded, other things being equal.

Box 1. An Aggregate Demand Curve

Box 1 **An Aggregate Demand Curve**

An aggregate demand curve shows the relationship between the price level and the quantity of a nation's final output demanded for a given year.



- *1. The real wealth effect: A higher price level can decrease real wealth in a nation and reduce consumer spending on final products.*
- *2. The real interest rate effect: A higher price level can increase interest rates, making credit more expensive and reducing the quantity of investment goods demanded.*
- *3. The foreign trade effect: A higher price level reduces foreign demand for exports and increases domestic demand for imports.*

Changes in Aggregate Demand

is a change in the amount of a nation's final products that will be purchased caused by something other than a change in the price level.

Changes in Aggregate Demand Can be Caused by:

- *A change in consumer demand (C).*
- *A change in investment demand (I).*
- *A change in government purchases (G).*
- *A change in net export demand (NE).*
- *Remember, GDP = C + I + G + NE.*

Box 4. Factors Influencing Changes in Aggregate Demand

Box 4 **Factors Influencing Changes in Aggregate Demand**

Changes in aggregate demand are caused by changes in the demand for domestically produced consumption goods or investment goods, changes in the demand for exports or imports, and changes in government purchases.

Changes that can cause an increase in aggregate demand	Changes that can cause a decrease in aggregate demand
▪ A decrease in real interest rates.	▪ An increase in real interest rates.
▪ An increase in the quantity of money in circulation.	▪ A decrease in the quantity of money in circulation.
▪ A decrease in the international value of the dollar.	▪ An increase in the international value of the dollar.
▪ An increase in the general level of wealth.	▪ A decrease in the general level of wealth.
▪ An increase in government purchases.	▪ A decrease in government purchases.
▪ A decrease in tax rates.	▪ An increase in tax rates.
▪ An increase in government transfers.	▪ A decrease in government transfers.
▪ Improved expectations about the future.	▪ Deteriorating expectations about the future.
▪ Higher income and improvements in economic conditions in foreign nations.	▪ Lower income and worsening economic conditions in foreign nations.

Aggregate supply

The aggregate quantity supplied *is the quantity of final products (measured by real GDP) that will be supplied by producers at a given price level.* ***Aggregate supply*** *is a relationship between the price level and aggregate quantity supplied.*

Aggregate supply

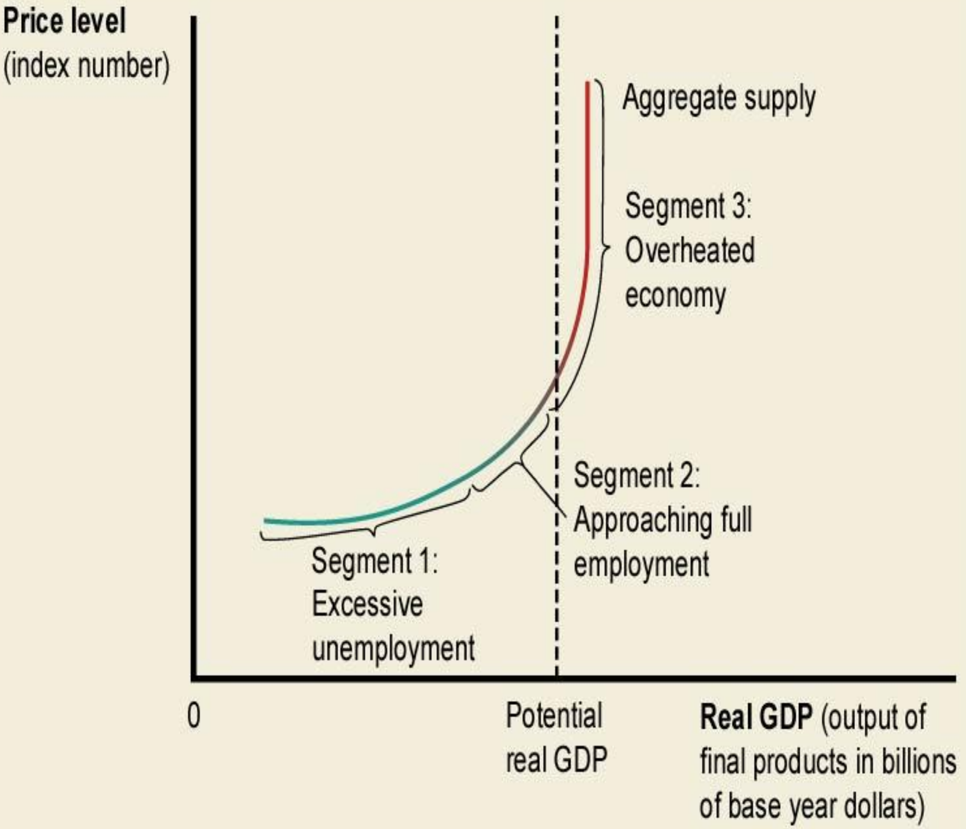
An ***aggregate supply curve*** *shows the aggregate quantity supplied for each possible price level over a given period. When drawing an aggregate supply curve, we assume that all input prices and the general availability and quality of productive resources in the economy are fixed. We also assume that technology doesn't advance over the given period.*

Box 6. The Segments of the Aggregate Supply Curve

Box 6

The Segments of the Aggregate Supply Curve

Because unit costs of production increase slowly at first, the aggregate supply curve is quite flat at low levels of production, but its slope becomes very steep as the economy's capacity is reached.   The point on the horizontal axis corresponding to the point at which the aggregate supply curve becomes vertical represents the physical limit to annual production.



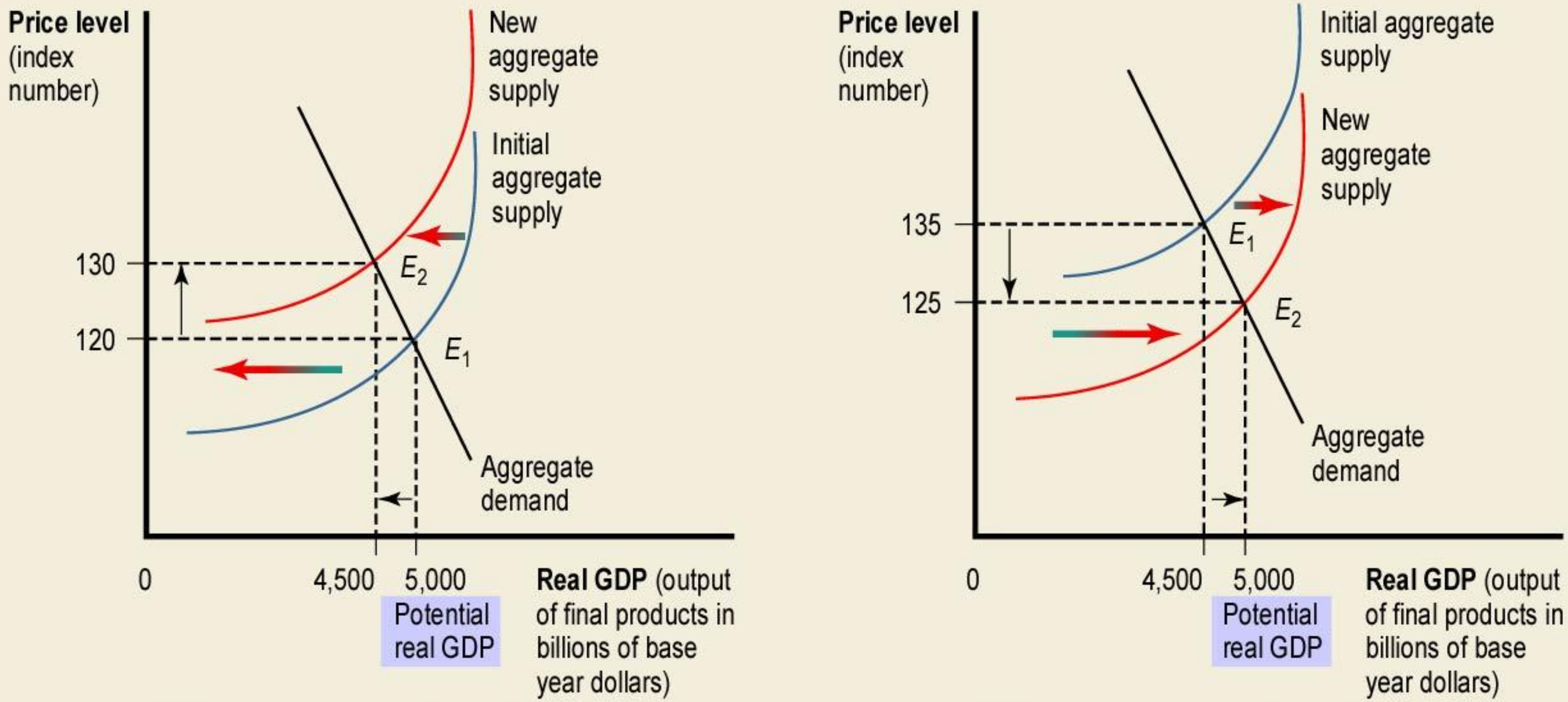
Changes in Aggregate Supply

A change in aggregate supply is a change in the amount of national production resulting from something other than a change in the price level.

Box 15. Changes in Aggregate Supply

Box 15 **Changes in Aggregate Supply**

A decrease in aggregate supply will raise the price level and reduce equilibrium real GDP. An increase in aggregate supply will affect macroeconomic equilibrium by reducing the price level and increasing real GDP, other things being equal.



A. A decrease in aggregate supply

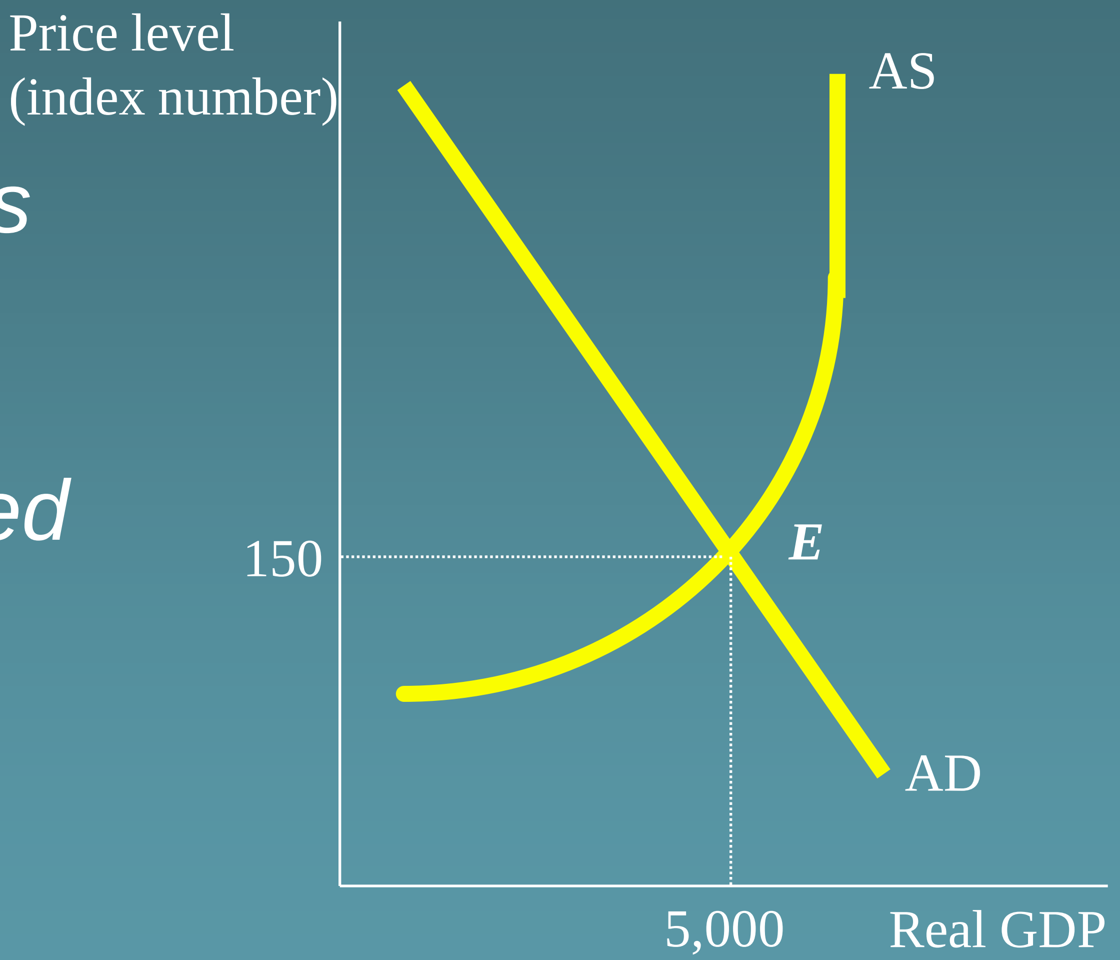
B. An increase in aggregate supply

Changes in Aggregate Supply Can be Caused by:

- *Changes in the availability of inputs.*
- *Changes in prices of raw materials, fuel, and other other material inputs.*
- *Changes in nominal wages.*
- *Changes in the productivity of inputs.*

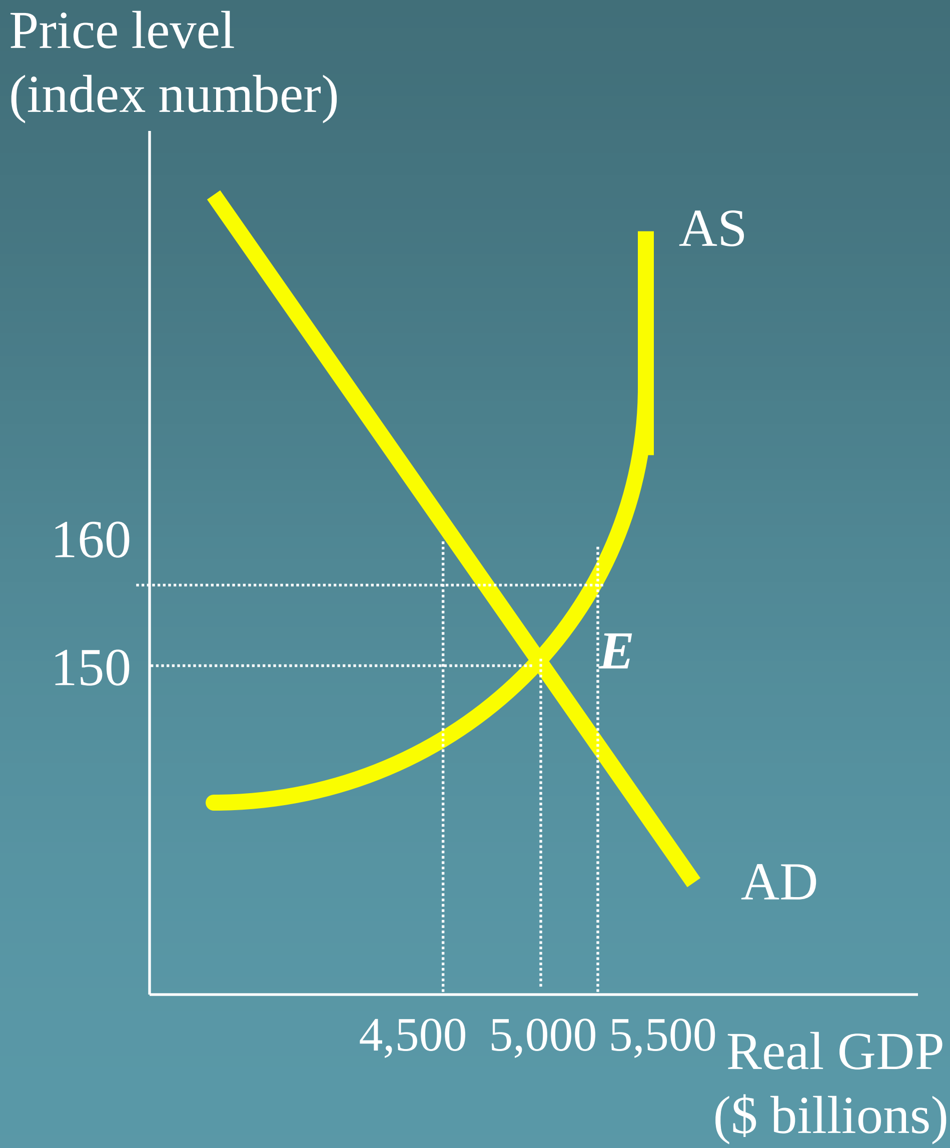
Macroeconomic Equilibrium

- *Macroeconomic equilibrium occurs for an economy when aggregate quantity demanded equals aggregate quantity supplied.*



Macroeconomic Equilibrium

- *When aggregate quantity demanded falls short of aggregate quantity supplied, there will be unanticipated buildup of inventories.*
- *As orders for new products and hiring decline, the price level and real GDP will fall.*



Macroeconomic Equilibrium

- *When aggregate quantity demanded exceeds aggregate quantity supplied, there will be unanticipated depletion of inventories.*
- *As orders and hiring increases, real GDP and the price level rise.*