

# Macroeconomics

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## Chapter 9: Aggregate Demand/Supply

- Sticky Prices and Their Macroeconomic Consequences
  - Flexible and Sticky Prices:
    - For most firms, the biggest cost of doing business is wages. If wages are sticky, firms overall costs will be sticky as well. This means that firms' product prices will remain sticky too.
    - Sticky wages cause sticky prices and hamper the economy's ability to bring demand and supply into balance in the short run.
  - How demand determines output in the short run:
    - **Short run in macroeconomics** - the period of time in which prices do not change or do not change very much.
- Understanding Aggregate demand curve:
  - **Aggregate demand curve (AD)** - a curve that shows the relationship between the level of prices and the quantity of real GDP demanded.
  - **Wealth Effect** - the increase in spending that occurs because the real value of money increases when the price falls.
  - Shifts in the Aggregate Demand Curve:
    - Changes in the supply of money: an increase in the supply of money in the economy will increase aggregate demand and shift the aggregate demand curve to the right.
    - Changes in taxes: a decrease in taxes will increase aggregate demand and shift the aggregate demand curve to the right.
    - Changes in government spending: at any given price level, an increase in government spending will increase aggregate demand and shift the aggregate demand curve to the right.
  - How the Multiplier makes the shift bigger:
    - **Multiplier** - the ratio of the total shift in aggregate demand to the initial shift in aggregate demand.

$$\text{Multiplier} = 1 / (1 - \text{MPC})$$

- **Consumption function** - the relationship between the level of income and consumer spending

$$C = C_a + b y$$

- **Autonomous consumption spending** - the part of consumption spending that does not depend on income.

- **Marginal propensity to consume (MPC)** - the fraction of additional income that is spent.

$$\text{MPC} = \text{additional consumption} / \text{additional income}$$

- **Marginal propensity to save (MPS)** - the fraction of additional income that is saved.

$$\text{MPS} = \text{additional savings} / \text{additional income}$$

- **Aggregate supply curve (AS)** - a curve that shows the relationship between the level of prices and the quantity of output supplied.

- o The Long run aggregate supply curve:

- **Long run aggregate supply curve** - a vertical aggregate supply curve that represents the idea that in the long run, output is determined solely by the factors of production.

- o The short run aggregate supply curve:

- **Short run aggregate supply curve** - a relatively flat aggregate supply curve that represents the idea that prices do not change very much in the short run and that firms adjust production to meet demand.

- Factors that determine the costs firms must incur to produce output:

- Input prices (wages and materials)
- The state of technology.
- Taxes, subsidies, or economic regulations.

- Understanding Aggregate Supply

- o **Supply shock** - external events that shift the aggregate supply curve.
- o **Stagflation** - a decrease in real output with increasing prices.

## Chapter 9 Quiz

- Prices for fresh fruit, vegetables, and other food products are examples of **auction prices**.
- Assuming a long-run aggregate supply curve, a decrease in government spending results in **no change** in output, and a **decrease** in price level.
- The multiplier represents the ratio of the total shift in aggregate demand to the **initial shift in aggregate demand**.
- Assuming the price level has not changed, how would an increase in the aggregate demand affect 'real' GDP; **it increases**.
- The short run in macroeconomics is the period in which **demand determines output**.
- If home prices are falling, consumers purchasing a home will find their purchasing power of money has increased. This benefit to consumers is called **the wealth effect**.
- Which one of the following would shift the aggregate demand curve to the left; **an increase in taxes**.

- The increase in spending that occurs because domestic goods become cheaper relative to foreign goods when the price level falls is known as the **international trade effect**.
- As the price level **increases**, the purchasing power of money **decreases**.
- Which of the following factors influence the position of the long - run aggregate supply curve; **the level of full employment output**.
- If prices are sticky **economic activity will not be coordinated efficiently**.
- During an economic boom **it is difficult for firms to recruit and retain workers**.
- The relationship between the level of prices and the quantity of real GDP supplied is known as **aggregate supply**.
- A decrease in spending on new homes while other things equal, **decrease aggregate demand**.
- Which of the following is a problem with the price system that can lead to fluctuations in output; **prices can be slow to adjust**.
- Assuming a long run aggregate supply curve, a decrease in taxes results in **no change** in output and **an increase**.
- The increase in spending that occurs because the demand for investment goods increases when the price level falls is known as **interest rate effect**.
- Which of the following would cause a decrease in aggregate demand; **a fall in investor confidence**.

## Chapter 10: Fiscal Policy

- Fiscal Policy and Aggregate Demand
  - **Fiscal Policy** - changes in government taxes and spending that affect the level of GDP.
  - **Expansionary Policies** - government policy actions that lead to increases in aggregate demand.
  - **Contractionary policies** - government policy actions that lead to decreases in aggregate demand.
- The fiscal Multiplier:
  - As the government develops policies to stabilize the economy, it needs to take the multiplier into account.
  - The total shift in the aggregate demand will be larger than the initial shift. As we will see later this chapter.
  - U.S. policymakers have taken the multiplier into account as they have developed policies for the economy.
- Limits to stabilization policy:
  - **Stabilization policies** - policy actions taken to move the economy closer to full employment or potential output.
  - **LAGS:**
    - **Inside Lags** - the time it takes to formulate a policy.