

Aggregate Demand, Aggregate Supply, and Inflation

Econ 202 Lecture 2

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- 1 Aggregate Demand and Aggregate Supply
- 2 Macroeconomic equilibrium
- 3 Inflation and Hyperinflation

Motivation

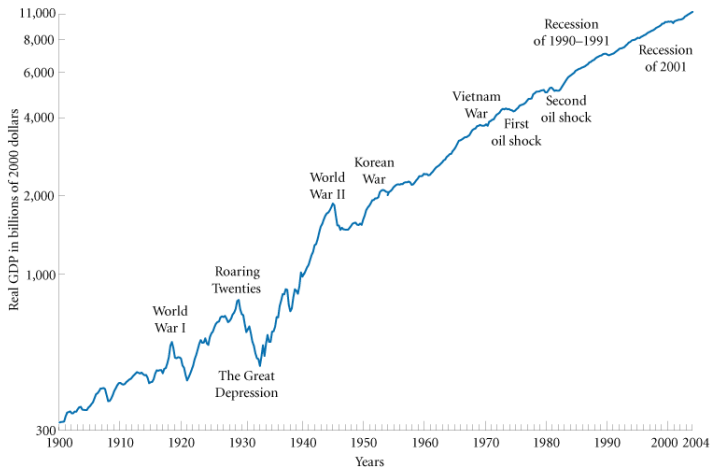


Figure: The Real GDP trend in the US economy since 1900

The Aggregate Demand (AD)

Who demands goods and services?

- ① households (C)
- ② firms (I)
- ③ the government (G)
- ④ RoWorld (NX)

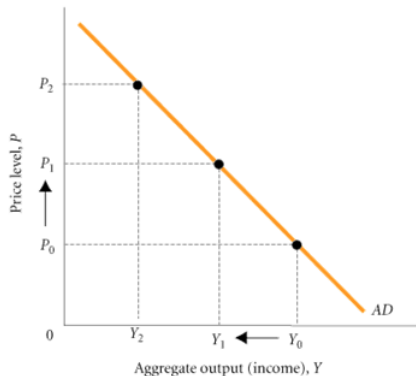


Figure: The AD curve

The Aggregate Supply (AS)

Who supplies goods and services?

- 1 households provide labor
- 2 firms produce
- 3 the government produces
- 4 RoWorld exports to us

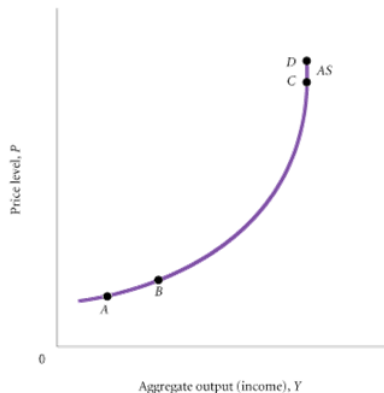


Figure: The AS curve

Macroeconomic equilibrium

Aggregate demand

Total demand for goods and services in the economy.

Aggregate supply

Total supply for goods and services in the economy.

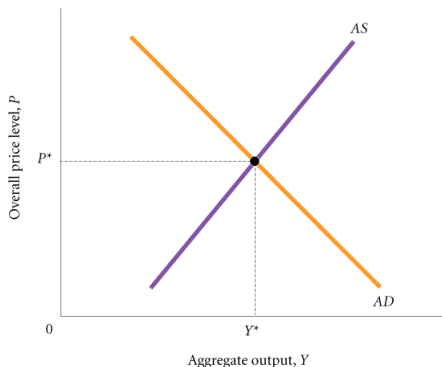


Figure: The AD and AS curves, and macro equilibrium

What causes macroeconomic *fluctuations*?

Macroeconomic cycles

Expansion

A period in which GDP rises due to an increase in AD or AS, or both.

Contraction

A period in which GDP falls due to a decrease in AD or AS, or both.

Recession

A state of the economy in which GDP contracts.

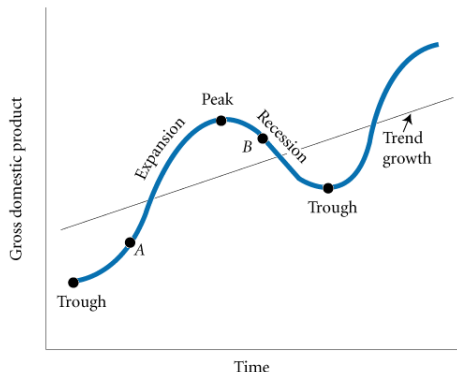


Figure: The macroeconomic cycle

Factors shifting AD

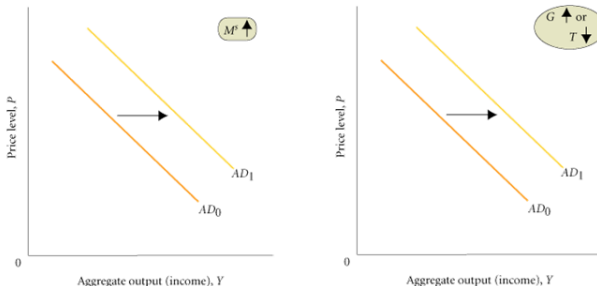


Figure: Factors shifting the AD curve

Expansionary monetary policy

$M^s \uparrow \rightarrow AD$ curve shifts to the right

Expansionary fiscal policy

$G \uparrow \rightarrow AD$ curve shifts to the right

$T \downarrow \rightarrow AD$ curve shifts to the right

Contractionary monetary policy

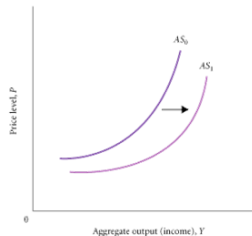
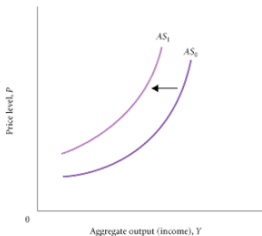
$M^s \downarrow \rightarrow AD$ curve shifts to the left

Contractionary fiscal policy

$G \downarrow \rightarrow AD$ curve shifts to the left

$T \uparrow \rightarrow AD$ curve shifts to the left

Factors shifting AS



Shifts to the Right
Increases in Aggregate Supply



- Lower costs
- lower input prices
- lower wage rates



- Economic growth
- more capital
- more labor
- technological change



- Public policy
- supply-side policies
- tax cuts
- deregulation



- Good weather

Shifts to the Left
Decreases in Aggregate Supply

- Higher costs
- higher input prices
- higher wage rates



- Stagnation
- capital deterioration



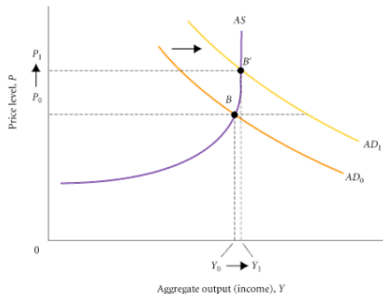
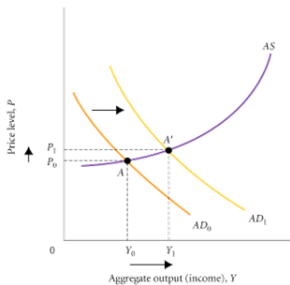
- Public policy
- waste and inefficiency
- over-regulation



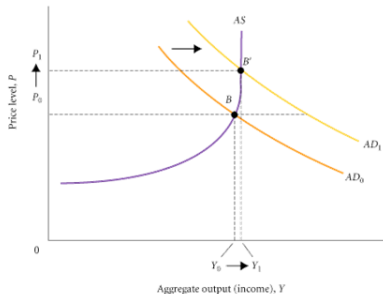
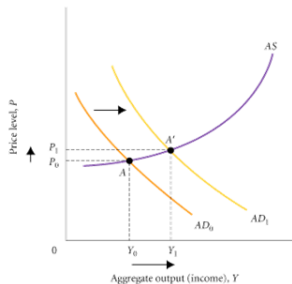
- Bad weather, natural disasters, destruction from wars



When do policymakers make mistakes?



When do policymakers make mistakes?



Comments:

- It is useful to stimulate the AD when the economy is in recession.
- Before AS has reached its capacity, stop stimulating the economy, and start worrying about inflation.

Inflation

Inflation

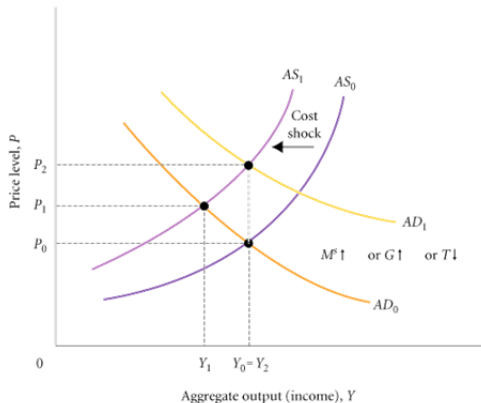
An overall increase in the price level in a given economy in a given year.

Cost-push inflation

Inflation caused by an increase in firm costs.

Demand-pull inflation

Inflation caused by an increase in AD.



Hyperinflation

A period of a very rapid series of price level jumps.

Factors causing hyperinflation:

- large G deficits covered with increased money supply
- sustained high money growth over a long period of time

